An Optional Simplified Income Tax?

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Asserting that a study of high-income individual income tax returns proves that "some taxpayers do not pay nearly enough; others pay too much," and urging that "[i]t is time we began to reduce the premium enjoyed by the taxpayer who has tax lawyers and accountants to show him ways to avoid paying taxes to his federal government," Senator Russell B. Long proposed an optional "Simplified Tax Method" in October of 1963 as an amendment to the administration's pending revenue bill (H.R. 3363, which became the Revenue Act of 1964). Modified and elaborated in the light of Treasury studies, the proposal was introduced again by Senator Long in 1964 "so that it may be studied fully" by Congress, the Treasury, and the public. No action has been taken on the bill as yet, but Senator Long announced that he would "seek action on it" during the 89th Congress.

Under the Long proposal, the individual taxpayer may elect to compute his federal income tax on a newly-defined base, so-called "simplified taxable income"—roughly speaking, adjusted gross income as defined by section 62 of the 1954 Code, enlarged by adding back certain items that are now excluded or deducted from gross income in arriving at adjusted gross income (e.g., tax-exempt interest; contributions to qualified employee and self-employed pension plans; intangible drilling and development costs; state, local, and foreign income taxes; percentage depletion; employee

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1 The 1963 proposal was described by Senator Long in a Senate speech on October 16, 1963, 109 Cong. Rec. 19706 (1963). It was referred to the Senate Finance Committee, which "tentatively approved the Amendment by a vote of 9-5, with the understanding that the provision is still subject to amendment." Press Release No. 2, Senate Finance Committee, December 13, 1963.

The 1964 proposal (S. 3250, 88th Cong., 2d Sess.), which is printed as an appendix to this article (infra at 37), was described by Senator Long in a Senate speech on October 2, 1964, 110 Cong. Rec. 23087-23098 (daily ed. Oct. 2, 1964).

Unless otherwise stated, references in the text are to the 1964 version. Comments attributed to Senator Long come from both his 1963 and 1964 remarks; to avoid peppering the text with distracting footnotes, I have not cited the pages in each instance, but the speeches are brief and the sources can be easily found. The context indicates, when relevant, whether the comment was made in 1963 or in 1964.
death benefits and sick pay; and the fifty per cent deduction for long-term capital gains).

In return for accepting this expanded tax base, and for renouncing all personal deductions (except for alimony payments), all dependency exemptions, and the credits for retirement income and partially tax-exempt interest, the taxpayer gets the benefit of a new rate schedule, ranging from 20 to 40 per cent on the first $50,000 (single persons) or $100,000 (joint returns) of "simplified taxable income" and rising to a maximum of 50 per cent on the excess above these amounts. The simplified tax method is optional with the taxpayer, but an election is to be binding for five taxable years, unless revoked or terminated sooner on the occurrence of certain events, of which the most important is a change in the Internal Revenue Code or Regulations that eliminates, in the opinion of the Treasury, "a major portion of the difference" between the tax liability of electing taxpayers as a class under the simplified method and their tax liability under regular (i.e., non-"simplified") law.

Moreover, the taxpayer may revoke the election at any time he chooses, in which event his tax liability for all prior years covered by the revoked election will be re-computed (based on regular rates), an additional tax of five per cent of the re-computed tax liability will be added, and the taxpayer will either pay the excess of this amount over the taxes previously paid by him under the "simplified" method or receive a refund. On the expiration of an election at the end of its normal five-year life, it may be renewed; but if the taxpayer terminates, revokes, or fails to renew his election, he may not return to the simplified tax method for five years unless the Treasury consents.

On introducing the simplified tax method in its original form in 1963, Senator Long said that the Treasury had estimated that it would be elected by about 12,000 taxpayers with adjusted gross income of $50,000 or more and by about 2,000 with adjusted gross income below $50,000, at an aggregate revenue loss of about $45 million. In announcing these 1963 estimates (based on proposed rates of 40 per cent for the first $50,000 or $100,000 of simplified taxable income and 50 per cent above these amounts), Senator

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*Infra* at 40. In states with a federally-based state income tax, the electing taxpayer will suffer a partially offsetting increase in his state tax burden unless he is allowed to compute "taxable income" for state purposes as he would have computed it *sans* an election.
Long held out the hope of a later extension of the method to benefit more taxpayers in the $10,000 to $50,000 bracket, but said that:

In the experimental stage this would not be practical because errors in estimates which cannot be foreseen at present could cost this nation several billions of dollars of revenue.  

In 1964, however, the proposal was amended to broaden its appeal, primarily by a reduction of rates to the 20–50 per cent schedule described above. With these changes, the simplified method would be elected by 313,000 taxpayers, according to Treasury estimates cited by Senator Long, at a revenue cost of $225 million.

On introducing the 1964 version, Senator Long said that former Secretary Douglas Dillon, Assistant Secretary Stanley Surrey, and others in the Treasury had displayed "a great amount of enthusiasm for this type of tax reform," and that former Commissioner Mortimer Caplin called it "the most hopeful thing he had seen in some time for bringing about fair, equitable, uniform tax treatment for all American taxpayers." The plan has also been warmly received by several members of the Senate Finance Committee, and in 1963 it was "tentatively approved" by the Committee itself. Even though these endorsements may have been intended more as encouragement than commitment, they attest to the allure of "simplification" and at the same time suggest that the implications of the proposal be carefully studied. I offer here my own—far from comprehensive—comments as a first step toward a more thorough public examination of the issues:

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3 109 Cong. Rec. 19706 (1963). Senator Long may have been cautious because of his disillusioning experience with qualified stock options, which "proved to be a much greater loophole than I, as a Member of the Senate at that time—not as a member of the committee—dreamed it would be." Id. at 19712.

4 The Treasury estimates quoted by Senator Long give the number of electing taxpayers by adjusted gross income class and the revenue loss as follows:

<table>
<thead>
<tr>
<th>AGI class (thousands)</th>
<th>Taxable returns (thousands)</th>
<th>Number electing (thousands)</th>
<th>Revenue loss (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10-20</td>
<td>6,709</td>
<td>10</td>
<td>*</td>
</tr>
<tr>
<td>$20-50</td>
<td>1,042</td>
<td>240</td>
<td>$85</td>
</tr>
<tr>
<td>$50-100</td>
<td>152</td>
<td>55</td>
<td>85</td>
</tr>
<tr>
<td>$100 and over</td>
<td></td>
<td>8</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>7,903</td>
<td>313</td>
<td>$225</td>
</tr>
</tbody>
</table>

* Under $2.5 million.

5 The 1964 version differs from the 1963 version in proposing an increase in the mini-
Summary of the Proposal

First, a description of the proposal, which takes the form of a new "Subchapter U—Election of Simplified Tax Method," to be added to Chapter 1 of Subtitle A (Income Taxes) of the 1954 Code. Its principal features are: (1) a definition of "simplified taxable income"; (2) a special rate schedule; (3) rules for making, revoking, and terminating the election; and (4) special rules to prevent tax avoidance.

"Simplified Taxable Income"

The base on which the simplified tax is to be imposed is "simplified taxable income." This concept, to be found in section 1393(a) of the proposal, builds on adjusted gross income as defined by section 62 of the 1954 Code, but makes the following modifications:

Additions to adjusted gross income. Adjusted gross income is enlarged by adding back most of the items that are specifically excluded from gross income by sections 101–119, including employee death benefits, tax-exempt bond interest, compensation for injuries or sickness, sick pay and other employer-financed accident and health benefits, dividends excludible under section 116, scholarships and fellowships, and a number of more minor items that are now excluded by statute from gross income. Not all of the exclusions granted by sections 101–119 are nullified; section 101(a) and (d) (proceeds of life insurance), section 102 (gifts and inheritances), section 108 (elective exclusion of income from discharge of indebtedness), and section 111 (recovery of bad debts, prior taxes, and delinquency amounts) remain intact.

The electing taxpayer must also include in "simplified taxable income" all foreign source income now excludable under section 911 (income for services during bona fide foreign residence or 17-out-of-18 month physical presence abroad), section 894 (income exempt by treaty), section 912 (government allowances for foreign service), section 931 (income from possessions of United States), section 893 (compensation of alien employees of foreign governments and international organizations), and section 943 (China Trade Act dividends).
Finally, "simplified taxable income" is to include government unemployment benefits, as well as a variety of items constituting compensation for the taxpayer's services: two-thirds of pensions and/or annuities under the Social Security and Railroad Retirement Acts (the untaxed one-third being treated as a return of the employee's contributions), employer contributions to pension and profit-sharing plans if the taxpayer's rights are non-forfeitable, employer-financed group term life insurance premiums, and the "spread" between the cost and the fair market value of stock acquired under qualified or restricted stock options or employee stock purchase plans.

**Denial of deductions.** Adjusted gross income is to be increased under the Long proposal not only by denying the statutory exclusions listed above, but also by denying certain deductions now allowed in converting gross income to adjusted gross income. The deductions to be denied, under section 1393(c) of the proposal, are: state, local, and foreign income taxes (sections 162, 164, and 212);⁶ the deduction of fifty per cent of the excess of net long-term capital gain over net short-term capital loss (section 1202); contributions to self-employed pension plans (sections 404-405); percentage depletion (since cost depletion remains an allowable deduction, the net effect is to disallow the excess of percentage over cost depletion); intangible drilling and development costs for oil and gas wells (section 263(c)); exploration and development expenditures for other natural resources (sections 615-616); circulation expenditures (section 173); and certain agricultural expenditures (sections 175, 180, and 182).

**Additional deductions.** Under existing law, most expenses which are deductible under section 162 and some of those deductible under section 212 are deducted from gross income in reaching adjusted gross income. Section 1393(d) of the proposal would depart from existing law by allowing all section 212 expenses to be deducted, as well as those section 162 expenses of an employee that are not listed in section 62(2) and hence are not now deductible by a taxpayer using the optional standard deduction. In addition, expenses that would be deductible under section 162 and section

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⁶The disallowance of state, local, and foreign taxes "on or measured by net income" is evidently based on the theory that they constitute a cost of living rather than of doing business even if levied on business income. No attempt is made, however, to disallow functionally equivalent taxes, although section 903 (foreign tax credit for taxes paid "in lieu of" a tax on income) attests to their existence. Although foreign income taxes cannot be deducted by the electing taxpayer, he can apply them as a credit—if I read the proposal correctly.
212 except for the fact that they are allocable to exempt income will be deductible by the electing taxpayer if the items to which they are allocable lose their exempt status. An example is interest paid on indebtedness to purchase tax-exempt bonds; the interest received being taxable to the electing taxpayer, the interest paid by him will become deductible.

*Personal deductions and exemptions.* In computing "simplified taxable income," the general rule is that neither the personal deductions of existing law nor the optional standard deduction are to be allowed. An exception is made for alimony payments, which will continue to be deductible, and for a few more minor items described below. The basic personal exemptions of $600 each for the taxpayer and his wife are allowed in computing "simplified taxable income," but not the additional exemptions for age and blindness or for dependents.

**COMPUTATION OF THE "SIMPLIFIED TAX"**

"Simplified taxable income" (viz., adjusted gross income, modified as described above) is the base to which the new tax rates are applied. The 1963 version imposed a "simplified tax" of 40 per cent of the first $50,000, $75,000, or $100,000 of "simplified taxable income" (depending on whether the taxpayer filed a separate, head-of-household, or joint return), plus 50 per cent of the excess. For taxpayers reporting an excess of net long-term capital gain over net short-term capital loss, however, the 25 per cent alternative tax was preserved. The 1964 version abandons the 1963 concept of a nearly flat rate in favor of graduation by steps from 20 per cent to 50 per cent, in order to expand the circle of electing taxpayers beyond the "handfull of high-income taxpayers" who were viewed by Senator Long as the principal beneficiaries of the 1963 proposal. Along with this change, however, came an elimination of the special treatment of long-term capital gains, which are to be taxed in the same manner as other income. (Section 1211(b)'s restriction on the deductibility of capital losses is retained, however, along with the capital loss carryover of section 1212(b).)

The rate schedules proposed by the 1964 version for single persons and for married persons filing jointly are:

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7 *Infra* at 16.

8 Since the 1963 proposal was geared to H.R. 8363 (the revenue bill of 1963), it made use of the proposed (but unenacted) reclassification of capital gains into class A capital gain, class B capital gain, and short-term capital gain.
As under existing law, married persons filing separate returns would be subject to the single persons schedule, while surviving spouses would pay at the joint return rate. Heads of households would be subject to rates intermediate between those in the table above.

If an electing taxpayer so desires, the income averaging provisions of sections 1301–1305 will apply in computing the simplified tax, but his "average base period income" will take into account only those years for which a simplified tax election was in effect. On the termination, expiration, or revocation of an election, election years may not be averaged with non-election years, and the taxpayer will not be eligible for averaging for a period of four years unless he consents to such regulations as the Treasury "may deem necessary to carry out the purposes of this section."

Finally, in computing his ultimate tax liability, the electing taxpayer is denied the credits provided by section 35 (partially tax-exempt interest) and section 37 (retirement income).

The Five-Year Election and Its Expiration, Termination, and Revocation

A taxpayer choosing the simplified tax for any taxable year must make his election within the time prescribed for filing the income tax return. The election is effective for that year and the four succeeding taxable years unless revoked or terminated. Before making an election, therefore, the taxpayer may review the financial results of the first year to which it will apply. Upon the expiration of an election at the end of its normal five year period, the taxpayer may renew it and thus enter upon another five-year cycle. If he fails to renew his election promptly, however, or if it terminates or is revoked for any reason, he may not make a new election for five years, except with the Treasury’s consent.

The election’s five-year life and the five-year "waiting period" for the taxpayer who fails to keep his election continuously in
force (which are reminiscent of, but not identical with, the conditions imposed on electing taxpayers by Subchapter S and the consolidated return regulations) are intended by Senator Long as safeguards against manipulation:

If the election could be changed every year without penalty, it could be abused by taxpayers electing in alternate years and bunching their deductions, tax-exempt interest, and so forth, in years when they do not elect. Thus, they would get the benefit both of the present tax system with its provisions favoring certain types of income and expenditures and the optional method with its low, effective rates. On the other hand, if the election were made effective for all time or for a very long period of time, very few taxpayers would elect because they would be unwilling to commit themselves for so long into the future when their circumstances might very well change. A 5-year election, however, should be long enough to prevent manipulation and yet short enough so that at least some taxpayers would be willing to commit themselves to get the benefit of favorable rates.

Even before an election's expiration at the end of its normal five-year life, however, it may terminate, be revoked prospectively, or (on payment of a moderate additional tax) be revoked retroactively:

**Termination.** A married taxpayer is permitted by section 1391 (a)(3) to elect only if his spouse makes, or has made, an election, and his election will terminate under section 1391(b) whenever an election is not in effect for his spouse. Thus, a termination will occur if (1) an electing taxpayer becomes married during his 5-year period to a spouse who has not, and does not, make an election; (2) if an election made by his spouse before their marriage expires during his five-year period and is not renewed; or (3) if his wife's election is revoked in one of the ways to be described herein. A divorce, however, does not terminate the election for either spouse.

**Prospective revocation.** A prospective revocation of an election terminates it under section 1391 (c) for the current year and for the remaining years of its five-year period, but does not affect prior election years. A revocation of this type is optional with an electing taxpayer under section 1391(d) if he is discharged in bankruptcy; if he becomes disabled within the meaning of section 213(g)(3) (inability to engage in gainful activity by reason of permanent physical or mental impairment) and at least fifty per cent of his gross income for the prior five years consisted of earned income; or if the Code or regulations are amended after his election so as to eliminate a "major portion" of the tax advantage of electing taxpayers "as a class."
Supervening physical or mental disability of a permanent character is presumably made a ground for revocation on the theory that it would be unfair to compel the taxpayer, who may have elected in order to get the benefit of the simplified tax rates for earned income, to forego the medical expense deduction and to report damages for personal injury or post-disability investment income (e.g., capital gains or tax-exempt interest) as "simplified taxable income." A bankruptcy discharge may similarly presage a substantial change in the taxpayer's financial status; if he were held to his election until its normal expiration, he would be subject to a minimum tax rate of twenty per cent no matter how modest his earnings, computed without the benefit of personal deductions or dependency exemptions.

More important than either of these grounds for revoking the election is a change in the Code or regulations that, in the view of the Treasury, eliminates "a major portion of the difference" between the simplified tax liability of electing taxpayers "as a class" and their regular (i.e., non-"simplified") tax liability. The most obvious event of this character would be a change in the tax rates (either a decrease in the normal rates, or an increase in the simplified rates) that substantially narrowed the gap between the two tax systems. Structural changes that could have the specified effect are: an expansion of the definition of capital gains or a reduction of the long-term holding period; new personal deductions, or a removal of the limits on existing deductions; more liberal dependency exemptions, either in coverage or dollar amount; a substantial increase in the ceiling on the optional standard deduction; changes in the averaging provisions of sections 1301-1305; etc. If the impact of a statutory change is debatable, the Treasury will obviously be pressed to resolve its doubts in favor of an amnesty; and whenever an amendment to the regulations is arguably disadvantageous to electing taxpayers, the Treasury will surely be charged with highhandedness if it refuses to permit them to renounce their elections.9

9 Because a disadvantageous amendment to the regulations would permit electing taxpayers to revoke their elections, the Treasury would find itself in an exquisite dilemma every time a loophole in the simplified tax regulations was discovered: should it close the loophole at the cost of opening the main gate, or leave the loophole open in order to keep the main gate closed? A cautious Treasury staff, foreseeing this difficulty, cannot avoid it by refraining from issuing regulations until accumulated experience enables it to be right the first time. This is because the proposal provides that elections for taxable years ending before the "tax avoidance" regulations (infra at 38) are issued need not be made until ninety days after that date.
The terms "major portion of the difference" and "electing taxpayers as a class" are sufficiently vague to make a prediction perilous, but some light on the probable frequency of "major change" amnesties may be shed by our experience with an analogous provision in the consolidated returns regulations. Under Treasury Regulations section 1.1502-11(a), permitting an affiliated group of corporations to terminate its election to file consolidated tax returns whenever the Code or consolidated return regulations are amended so as to make such returns "substantially less advantageous to affiliated groups as a class," taxpayers were allowed to terminate their elections on enactment of the 1954 Code, the Technical Changes Act of 1958, and the Revenue Acts of 1962 and 1964; and amnesties were declared under the somewhat more liberal rules prevailing before the 1954 Code for calendar year taxpayers in 1941, 1943, 1944, 1946, 1947, 1948, 1950, and 1952. There being more for Congress to tinker with in the individual income tax area, I would expect "major change" amnesties to be declared even more frequently under the simplified tax method. Unless we encounter an unprecedented series of "do nothing" Congresses, then, taxpayers are not likely to be frozen into the simplified tax system for more than two or three years at a spell, despite the election's theoretical five-year life.

Retroaction revocative. Responding to complaints that the election rules of his 1963 proposal were "too harsh, particularly in cases where the taxpayer has suffered unexpected financial reverses," Senator Long's 1964 version includes a provision for a retroactive revocation, exercisable by the taxpayer at any time he desires. Such a revocation wipes out the election ab initio, requiring a recomputation of the taxpayer's taxable income and tax liability under the normal rules applicable to non-electing taxpayers. The recomputed tax liability is increased by 5 per cent, and the difference between this amount and the amount actually paid by the taxpayer is either assessed as a deficiency, or refunded, with interest.

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10 The 1963 version of the simplified tax proposal used the same language as Regs. § 1.1502-11(a) (1955). I am not sure whether the somewhat different 1964 phraseology was intended to preserve, liberalize, or restrict the scope of the 1963 provision.

11 PEEL, CONSOLIDATED TAX RETURNS § 7.06 (1959).

12 The 5% additional tax is based on the recomputed tax for the year in question. Because it takes no account of the difference between the simplified and "normal" tax liabilities, a taxpayer who saved very little by electing must pay the same additional tax for revoking his election as the taxpayer whose saving was substantial. Interest, however, is based on the deficiency alone.

13 A deficiency may be assessed or a claim for refund filed "notwithstanding any law
As will be seen, although the provision for retroactive revocation of the election was designed to aid taxpayers suffering "unexpected financial reverses," it will be of much less value to them than to taxpayers enjoying unexpected financial windfalls.

**Special Anti-Avoidance Regulations**

The proposal, in language taken from section 1502 (consolidated returns), empowers the Treasury to issue regulations for determining and adjusting the tax liability of an electing taxpayer "in such manner as clearly to reflect the income tax liability of such taxpayer and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability." The regulations may provide for the distribution, apportionment, or allocation of gross income, exclusions, deductions, and other relevant items between the electing taxpayer and "any other person or persons." Finally, the simplified tax regulations, like those governing consolidated returns, are to apply not only to the elective period, but also—without any explicit time limit—to taxable years before and after this period. The statute of limitations is extended so that a deficiency "attributable" to the regulations may be assessed at any time until the statute has run on the last taxable year for which the election is in effect.

In thus bestowing jurisdiction on the Treasury over non-election years and non-electing taxpayers, the anti-avoidance provision is presumably aimed at "cake-eating" plans to shift income, deductions, and other items from election years to non-election years and from electing taxpayers to related non-electing taxpayers (and vice versa), in order to get the benefits of the simplified tax system without its burdens. By authorizing the Treasury to issue regulations of such unprecedented breadth, the draftsmen of the proposal betray an unmistakable (though no doubt grudging) respect for the ingenuity that creates the "gimmicks" and "schemes" which Senator Long hopes to eliminate by the simplified tax method itself. At the same time, they come close to confessing that the tax-avoidance

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12a *Infra*, at 26.

13a As will be seen (*infra* at 22), special rules are also prescribed to forestall the use of trusts to shift various items of income and deduction to non-election years or non-electing taxpayers.
potential of the simplified tax method is so great that the legislative process cannot prescribe rules to control it, and must transfer the task to the Treasury.

For reasons that are set out later, I think that the draftsmen have properly assessed the dangers, but that they have satisfied themselves too readily that Treasury regulations will be an effective, or desirable, remedy.

**THE NEW TAX BASE: “SIMPLIFIED TAXABLE INCOME”**

In analysing Senator Long’s proposal, I turn first to its central idea and primary structural reform—the formulation of a new tax base (“simplified taxable income”) to be taxed at lower rates, so that “upper income taxpayers [may] avail themselves of a relatively simple tax system under which all income is treated alike and there are no complicated personal deductions.” This aim has been espoused for some time by students of federal income taxation, and on recently emerging from the shelter of Academe, it has gained some support from the American Bar Association. Disregarding for the moment the optional feature of Senator Long’s proposal, which was absent from its predecessors, how well does it achieve this aim of “a relatively simple tax system” in which “all income is treated alike”? 16

The first step in answering this question is to note that the proposal expands the tax base primarily by nullifying some (not all) of the statutory exclusions of sections 101–119 and by including certain benefits deriving from the taxpayer’s personal services: foreign source income earned abroad; social security, railroad retirement, and unemployment benefits; pension and profit-sharing trusts; qualified stock options; and group-term life insurance premiums paid by the employer.

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16 In examining this question, I am accepting for the moment the Long proposal’s premise that a tax system in which “all income is treated alike” would be more equitable than existing law. In point of fact, I am very skeptical of this premise, and hope to show in a forthcoming article that no income tax base, no matter how “comprehensive,” can be “neutral” or devoid of “preferences,” and that the “comprehensive” tax bases that have been offered to us so far as substitutes for “taxable income” as now defined have not ventured even ankle-deep into the treacherous waters of “neutrality.”
Once we go beyond the statutory exclusions of sections 101-119, however, we find a number of other candidates for inclusion in a tax base that seeks to “treat all income alike.” Three of the most obvious are the net imputed rent of owner-occupied homes, the interest earned on life insurance reserves (reflected in the increase in cash surrender value), and the accrued appreciation in assets transferred by gift or at death. Their omission is evidently not to be explained by the taxpayer’s possible shortage of cash to pay the tax; the Long proposal requires many other items to be included in the tax base though not received in, or easily converted to, cash (contributions to pension and profit-sharing plans, a lessee’s improvements to the lessor’s property, group-term life insurance premiums, etc.). Almost all advocates of a “comprehensive” tax base have called attention to the omission of imputed rent, life insurance interest, and accrued appreciation at death from gross income as now defined, and it is surprising to find that Senator Long’s proposal leaves these areas untouched.

Equally surprising is the proposal’s placid acceptance of the Code’s numerous non-recognition provisions, which afford shelter to many items that could be included in a comprehensive tax base. I refer to the non-recognition of gain (and sometimes of loss) on exchanges in mergers and other corporate reorganizations, splits-offs, exchanges of “like kind” properties, dispositions of personal residences and condemned property if replaced by the taxpayer, and so on.\(^{17}\) Although the taxpayer’s economic circumstances are not always radically changed by such exchanges, they often are; and he sometimes comes out of the exchange with readily marketable property. To be sure, these provisions are commonly regarded as postponing the recognition of gain, rather than excluding it permanently, but postponement in itself is a “special provision” favoring a restricted class of income, and in fact it frequently results in a full-scale exclusion (e.g., when the assets are held until death). In any event, the non-recognition provisions share both of these characteristics with some of the exclusions that Senator

\(^{17}\) The 1963 version authorized the Treasury to issue regulations prescribing the extent to which § 721 (nonrecognition of gain or loss on contribution to a partnership), § 1031 (exchanges of “like kind” property), § 1036 (exchanges of stock for stock of same corporation), as well as all the provisions of Subchapter C, would apply to transfers during the election period or the two years immediately preceding or following. As will be seen, the Treasury’s power to issue regulations under the 1964 proposal may include some authority over these transactions, but presumably this power is restricted to exchanges motivated by tax avoidance; it can hardly have been intended to nullify the normal functioning of the statutory non-recognition provisions.
Long's proposal proposes to eliminate (e.g., lessee-constructed improvements under section 109), and they rank high in any realistic ranking of complicated statutory provisions that enable the rich to grow richer without tax cost.

Despite this fact, Congress had quite valid reasons for enacting most if not all of these nonrecognition provisions, but its reasons for enacting many of the exclusions that Senator Long proposes to abolish were equally compelling. If an investor can postpone the recognition of gain, even though it is realized on a corporate merger, why should an employee be forbidden to postpone the recognition of earnings fed into a pension or profit-sharing plan, or a lessor be forbidden to postpone income resulting from his lessee's improvements?

These are not the only inconsistencies in the simplified tax method's approach to the postponement of income. By accepting without qualification the accounting methods of existing law, it preserves the right to postpone the recognition of realized income through use of the installment and LIFO method of accounting. Here again, there is a striking difference between the proposal's rejection of the postponement of earned income through the use of qualified pension and profit-sharing plans and its tolerance of postponement in other areas. Senator Long may have persuasive reasons for these distinctions; but whatever they turn out to be, they will assuredly be inconsistent with the claim of a "simplified" tax base in which "all income is treated alike."

There are many other puzzling, debatable, or fine distinctions between items that must be included in "simplified taxable income" and items whose exclusion under existing law is preserved. Among these distinctions are the following:

- scholarships and fellowships become taxable, but prizes for notable achievement under section 74(a) remain exempt;
- unemployment benefits become taxable, but strike benefits remain exempt if constituting gifts under section 102;
- employee death benefits and damages for personal injury and sickness become taxable, but not compensation for wrongful death, life insurance proceeds, or gifts and inheritances;
- scholarships and military mustering-out pay become taxable, but not "G.I. benefits" payable to veterans;
- workmen's compensation payments and damages for personal injury become taxable, but not compensation, pensions, or

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18 See also note 36 infra.
other benefits received by veterans for either service or non-service connected disability;

distributions of stock to comply with a federal anti-trust order are denied the benefit of section 1111, but distributions to comply with orders of the F.C.C., S.E.C. or Federal Reserve Board continue to qualify for favorable treatment under section 1071, sections 1081–1083, and sections 1101–1103;

income from improvements constructed by a lessee on the lessor’s property (section 109) becomes taxable, but income from discharge of indebtedness continues to be excludible if applied to reduce the basis of the taxpayer’s property (section 108); and

contributions to pension and profit-sharing plans become taxable to the employee, but not deferred compensation of the type described in Revenue Ruling 60–31.10

Turning to the area of business deductions, we find another series of decisions that rest on no consistent policy judgments, or at least none that I can detect. The disallowance of percentage depletion and natural resource development expenses seems to reject the “incentive” function of income taxation in order to achieve a “purified” tax base and prevent the taxpayer from deducting more than his investment over the life of an asset. But why does the proposal preserve the investment credit, which also serves an incentive purpose and, taken in conjunction with depreciation, similarly inflates the allowance for investment? (It is not that credits are uniformly preserved by the proposal; the retirement income credit is eliminated.) Similarly Janus-faced is the proposal’s treatment of the thicket of provisions for the deductions or rapid amortization of capital outlays. It bravely disallows deductions under section 173 (circulation expenditures), section 175 (soil and water conservation expenditures), section 180 (fertilizer), and section 182 (clearing farm land), thus restoring the “correct” treatment of these items (viz., as capital outlays); but it preserves the deductions allowed by section 169 (grain-storage facilities), section 174 (research and experimental expenditures), section 177 (trademark and trade name expenditures), and section 179 (additional first-year depreciation for small business). (At the risk of interrupting my recital of inconsistencies, I must admit here that a senator who takes on the oil and gas, newspaper, and farm lobbies all at once deserves a Silver Star, and will probably get a Purple Heart as well.)

Just as the twin objectives of "simplification" and "equity" leave many questions unanswered in the treatment of exclusions and business deductions, they also leave room for judgment in deciding which personal deductions shall be allowed and which denied. The keynote of the simplified tax system, in both its 1963 and 1964 versions, is the elimination of personal deductions, but between 1963 and 1964, Senator Long relented enough to restore the deduction for alimony. Since he had promised in 1963 "to resist with all of my courage and ability any effort to make this [simplified tax] system the subject of loopholes for the benefit of favored taxpayers," we must assume that the deduction for alimony payments is not a "loophole." I agree, but I would not find it easy to defend a deduction for alimony while opposing exemptions for minor children and other dependents; nor am I sure that the deduction for alimony is any more plausible than a deduction for extraordinary casualty losses or medical expenses. For this reason, I have no confidence whatsoever that a simplified tax system with a deduction for alimony would not soon be amended to provide allowances for these other costs of living.

In point of fact, alimony is not the simplified tax system's only personal deduction to create disparities and hence to invite the restoration of still other deductions. Bad debt losses are allowed even though the loan was an accommodation to a relative or friend, unconnected with the taxpayer's business or profit-oriented activities. If an electing taxpayer lends his car to a friend, and it is wrecked, the casualty loss is not deductible in computing simplified taxable income, but if a sum of money is lent in the same spirit of friendship, and the debt is not repaid, the loss is deductible. If anything, I would argue for precisely the opposite results; the casualty loss is almost certainly unexpected, while the friend's inability to repay the loan may have been foreshadowed but disregarded out of generosity, and the taxpayer is not likely to exhaust a normal creditor's remedies to collect such a debt.\(^{20}\) In

\(^{20}\)To be sure, the ex-wife must report any amount deducted by her husband; but if the net effect is to reduce the aggregate tax burden on the individuals concerned (as it almost always is), the alimony deduction differs from the other personal deductions in a technical sense only. Moreover, if parents were allowed to deduct the cost of supporting their children on condition that any deducted amounts be included in the child's gross income, we would have a nearly-perfect parallel to the alimony deduction. If the latter is acceptable, why not the former?\(^{21}\)

\(^{21}\)The difficulty of proving that such a debt was intended as a gift from the outset, or that the taxpayer did not try hard enough to collect it, contributed to the enactment of § 166(d), requiring uncollectible nonbusiness debts to be deducted as short-term
response to these arguments, it may be said that taxpayers can insure more easily against most (not all) casualty losses than against bad debts, but this does not seem conclusive. Still less does it prove that an allowance for uncollectable personal debts should be preserved when other personal deductions are being jettisoned.

A more minor point is the preservation of section 212(3), allowing expenses incurred “in connection with the determination, collection, or refund of any tax” to be deducted even though the problem or dispute does not stem from the taxpayer’s business or profit-oriented activities. A deduction for the cost of litigating one’s federal tax liability has a “due process” flavor, and might be regarded as the rich taxpayer’s equivalent of Powell v. Alabama and later “right to counsel” cases. Under section 212(3), however, taxpayers have also been allowed to deduct the cost of planning tax-reduction arrangements, an allowance that conflicts with Senator Long’s goal of reducing “the premium enjoyed by the taxpayer who has tax lawyers and accountants to show him ways to avoid paying taxes to his Federal government.”

Income-splitting is another area of the law that ought to be examined systematically in promulgating a comprehensive tax base purporting to treat “all income alike.” The proposal, requires the electing taxpayer to include the income of certain trusts in his “simplified taxable income”; these provisions are discussed elsewhere and need not be described again here. Although the proposal thus acknowledges (albeit indirectly) that the income-splitting rules of existing law are inconsistent with the aims of capital losses. See Putnam v. Commissioner, 352 U.S. 82 (1956). This restriction, however, does not offset the anomaly of allowing such debts, if not incurred in a business or profit-oriented context, to be deducted while other personal deductions are disallowed. The electing taxpayer may apply nonbusiness bad debts against his capital gains; indeed, since the simplified system taxes capital gains in full at the ordinary rate, the right to deduct uncollectible personal debts may be even more valuable, comparatively speaking, to the electing than to the non-electing taxpayer.

If the electing taxpayer is to be allowed to deduct bad debts even though they are not business-connected because of the difficulty of distinguishing between “personal” loans and those that stem from a business or profit-making motive, what is the rationale for disallowing a deduction for interest paid by the taxpayer on “personal” loans? The distinction between personal and profit-oriented transactions is difficult to draw, whether the taxpayer is the borrower or the lender.

23 Carpenter v. United States, 338 F.2d 366 (Ct. Cl. 1964) (Davis, J., dissenting) (advice to minimize tax consequences of divorce settlement).
24 Infra at 20.
the simplified tax method, it does not venture very far into this well-stocked game preserve.

Turning from the details of "simplified taxable income" as defined by the Long proposal, to an overall view of the concept, one must acknowledge that it is an ambitious first step toward a more comprehensive tax base. Many omissions remain, however, so that a structure in which "all income is treated alike" is still a long way off. In advocating "drastic broadening of the tax base" along with "dramatic flattening of the rate scale," Professor Blum has pointed out that his aims can be achieved only by "leaning over backwards before allowing any [preferential provisions] to remain in the law," because the retention of even a single preference makes rate reduction less feasible, invites the charge of group-favoritism, and encourages the retention or later restoration of other exceptions. To these powerful arguments—which, in my opinion, cannot be rebutted but will not be heeded—the elective feature of Senator Long's proposal compels two more to be added. First, the enactment of the simplified tax method would almost certainly doom the hopes of those who favor a mandatory expansion of the tax base. To disarm those who fear that his proposal would be the opening wedge to compulsion, Senator Long has said:

I would like to emphasize that this method is optional and that taxpayers could continue under the rates and other provisions [of existing law]. . . . There will be those who will fear that the alternative method of taxation might eventually become the only system of taxation open to them. To those persons, I can assure them that I would strenuously oppose any such effort.

Since the elimination of the "gimmicks" and "tax-avoidance schemes" that are so eloquently criticized by Senator Long would put non-electing taxpayers on a par with electing taxpayers, Senator Long seems to be saying that he disagrees with existing law but will defend it to the death. Second, every omission from "simplified taxable income" when the proposal is initially enacted will have a claim to immortality. After taxpayers have made their elections and adjusted their financial affairs to the new system, they will unquestionably regard any attempt to expand the tax base as a breach of faith, if the rules governing the revocation of elections are not liberalized, and perhaps even if they are. If the

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25 But see note 16 supra.
26 Blum, supra note 15, at 679.
27 Such liberalization could be accomplished, for example, by allowing revocations even if electing taxpayers are not prejudiced "as a class," by waiving the penalty on a
definition of "simplified taxable income" is to be truly comprehensive, therefore, it is now or never.

The Status of Related, Non-Electing Taxpayers

Because Senator Long's simplified tax method applies only to those individual taxpayers who choose to elect it, and does not apply at all to corporations and trusts, it invites the shifting of income and deductions from the electing taxpayer to non-electing members of his family, and to his trusts and corporations. (An elective system would have this effect even if the election committed the taxpayer to use the system for life, without possibility of parole.) If an electing taxpayer engaged in the oil business or in farming, for example, transfers these activities to (or has them conducted from the outset by) a wholly-owned corporation, the business income can be reduced by the allowances for percentage depletion, intangible drilling and development costs, soil and water conservation expenditures, etc. These deductions would be denied if he operated as a proprietorship. Moreover, the corporation will be able to deduct its state, local, and foreign income taxes, although the electing taxpayer cannot. A corporate income tax on the balance could then be eliminated by an election under Subchapter S or minimized by the payment of a salary to the electing taxpayer for his personal services, and his tax on his salary or Subchapter S income can then be computed at the favorable "simplified" rates.

While he is about it, the individual taxpayer might as well allow the corporation to contribute to any charities that he wishes to aid, since contributions are deductible by it up to the five per cent limit of section 170(b)(2) but would be "wasted" if made by him. A wholly-owned corporation will also be useful to the electing taxpayer who holds state and municipal bonds or appreciated securities; if they are transferred to the corporation, the bond interest will qualify for the exclusion of section 103 when received by the corporation, and a gain on a corporate sale of the appreciated securities will qualify for the favorable capital gain rate if a Subchapter S election is not in effect. The reinvested proceeds will be owned by the corporation, rather than by the taxpayer in his own right, but this is not necessarily disadvantageous; he may hold the stock of the corporation until death, transfer it by gift, borrow against it, or realize on it by a sale or liquidating distribution retroactive revocation, and by shortening the waiting period before a new election may be made after revocation.
when he has an offsetting capital loss or after his simplified tax election has expired.

If the electing taxpayer does not wish to employ a corporation as the vehicle for preserving the special allowances that he cannot enjoy directly, he may be able to transfer some of these benefits to a member of his family. By giving the farm or oil business to a child, for example, he can keep the deductions for state income taxes, percentage depletion, intangible drilling costs, and soil and water conservation expenditures in the family, even though he receives a salary as manager of the business and reports it at the favorable simplified tax rates. For some taxpayers, the resulting reallocation of wealth within the family may not be appealing, even if it merely anticipates the intended testamentary arrangement; but for others, the tax saving will surely be irresistible.28

Finally, the trust, which has served so often to lighten or nullify burdens imposed by the law on natural persons, is another medium for perpetuating tax allowances despite an election under Senator Long's proposal. The electing taxpayer who customarily makes charitable contributions, for example, need not accept passively the simplified tax method's disallowance of deductions; if he owns income-producing property, he can transfer it to a ten-year trust 29 for charity and the income will not show upon his tax return even though he will get back the corpus at the end of the ten-year period. In the meantime, he can sprinkle the income around among charitable donees selected at his pleasure, and the trust will pay no tax because of its unlimited charitable deduction. Moreover, if he is foresighted enough to create the trust before he elects to come

28 Many other intra-family transfers could be employed to preserve tax benefits that in theory must be renounced by the electing taxpayer, including: (a) a transfer of state and municipal bonds to a member of the family, who can exclude the interest from his gross income under § 103; (b) a gift (or a sale at the electing taxpayer's adjusted basis) of appreciated securities to a member of the family, who can report his gain on selling them at the favorable capital gain rate; (c) a transfer of the electing taxpayer's residence to a member of the family, who will pay and deduct the real property taxes and mortgage interest but allow the taxpayer to occupy the premises rent-free; and (d) a transfer of income-producing property to adult children or parents who would otherwise be supported directly by the taxpayer, thus preserving, through the medium of the transferee's personal exemption and standard deduction, the substance (though not the form) of the dependency exemption. In some cases, an election under the simplified tax system would only strengthen pressures that now exist to make such transfers; but in other cases, it would create a pressure where there now is none.

29 The trust must have a duration of at least ten years because the exception of § 673(b) for two-year charitable trusts is nullified by § 1394(b)(4) of the Long proposal. If the income of a ten-year charitable trust is not to be attributed to grantor, however, I see no valid reason for not allowing taxpayers to deduct, as existing law permits, straight-forward contributions to charities.
under the simplified tax method, and is willing to vest the reversionary interest in his wife rather than himself, he may be entitled to a charitable deduction for the fair market value of the anticipated income.\textsuperscript{30} Aside from its utility in preserving the charitable deduction (in substance, though not in form), a trust could be used to operate a business and thus to benefit from the ostensibly unallowable deductions for percentage depletion, soil and conservation expenditures, state income taxes, etc.\textsuperscript{31}

Arrangements to shift income, deductions, and other allowances from an electing taxpayer to related persons and entities who can “use” them would, of course, have to run the gauntlet of the income-splitting and similar rules, both statutory and judicially created, of existing law. These rules would filter out some devices of an egregious character, but plenty of leeway would be left for the taxpayer who refrained from crowding his luck. If a transfer is tolerated for regular tax purposes, it might of course be argued that it does not become objectionable merely because the taxpayer has elected to be governed by the simplified tax method. Consistently with his dissatisfaction with existing law, however, Senator Long adopts the contrary view; and his proposal seeks to impose additional restrictions on such arrangements, when employed by electing taxpayers to preserve the special allowances of existing law.

\textsuperscript{30} § 170(b)(1)(D) is intended to bar a deduction if the reversionary interest is vested in the grantor himself. (I say “intended,” because the language of the provision may fail to achieve its purpose; the limitation comes into play if the grantor has a 5% or greater reversionary interest “in the corpus or income of that portion of the trust with respect to which a deduction would . . . be allowable,” and it is arguable that in the trust described in the text, the deduction relates to income while the reversionary interest relates only to corpus.) Unless a reversionary interest in the grantor’s wife is treated as an interest vested in the grantor (e.g., because relieving him pro tanto of his obligation to support her), the deduction is not barred by § 170(b)(1)(D).

Whether the reversionary interest is vested in the grantor or in someone else, the deduction might be attacked on the ground that it is based on an income item that has not been and will not be included in the taxpayer’s gross income, cf. \textit{Altsop v. Comm’r}, 290 F.2d 726 (2d Cir. 1961); but this line of attack seems not to have been explored, even by the commentators, perhaps because § 170(b)(1)(D) is thought to pre-empt the field. See Neuhoff, \textit{How to Make Money by Giving It Away: Tax Consequences of Creating a Charitable Trust}, 23 U. Pitt. L. Rev. 105 (1961).

\textsuperscript{31} As I read the 1964 proposal, the trust would be entitled to the deductions described in the text even if its net income is distributable (and taxable) to the grantor. (The result would be substantially the same as incorporating the business and making an election under Subchapter S, supra at 19.) If the Treasury is authorized by the proposal’s tax-avoidance rules to promulgate regulations that would deny these deductions to the trust when an electing taxpayer is its sole beneficiary, he could adjust his plans to the rules with only a limited loss of control by causing the trust to pay him a salary for his services and to distribute or accumulate the balance for members of his family.
I have already mentioned section 1394(a) of the proposal, authorizing the Treasury to prescribe regulations requiring an electing taxpayer’s return “clearly to reflect the income tax liability of such taxpayer and the various factors necessary for the determination of such liability . . . in order to prevent avoidance of such tax liability.” 32 This is sweeping language, but I doubt that a taxpayer’s tax liability is inaccurately reported if his wholly-owned corporation operates a farm or oil venture and claims deductions for percentage depletion, intangible drilling costs, and state income taxes, or if it sells appreciated securities formerly owned by him and reports the profit as long-term capital gain. If the property is transferred on the very eve of a sale or other transaction, of course, a readjustment would be appropriate, but in such blatant circumstances, the Treasury’s powers under existing law would probably need little if any support from the proposed new regulations. And if the case does not cry out so powerfully for a readjustment (e.g., if the corporation owns the business or property from its inception rather than acquiring it at the last minute, or if the electing taxpayer is not the sole shareholder), I am even more skeptical of the effectiveness of the proposed regulations.

In authorizing the promulgation of “anti-avoidance” regulations, the proposal establishes no presumptions, says nothing about tax avoidance or business purpose, lays down no rules of “relatedness,” and prescribes no specific remedies. It is innocent, in short, of all of the details that most comparable statutory provisions of existing law possess in abundance. These omissions may imply that the Treasury is to have a roving commission to correct everything that in its view needs correction, and that it can prescribe “regulations” that read like section 367. A more plausible view of the Treasury’s authority, however, is that its rules must be general in content and applicability, and that the courts will have the last word on whether or not the electing taxpayer’s income tax liability is “clearly reflected” by his return.33 In short, in this area the proposal feeds the Treasury plenty of red meat, but may produce little more than ferocious gestures.

So far as trusts are concerned, the Treasury’s general power to

32 Supra at 11.
33 The 1963 version of Senator Long’s proposal authorized the Treasury to prescribe “[t]he extent to which subchapter C of Chapter 1 (relating to corporate distribution and adjustments) . . . shall not apply to transfers made by [electing] taxpayer in any taxable year for which an election . . . is in effect or for the two years immediately preceding or following such taxable years.” Here again, the Treasury’s authority was to issue regulations, not the type of ad hoc rulings that are handed down under § 307.
issue "anti-avoidance" regulations is buttressed by several special rules, but they are of limited applicability and seem inadequate even for the modest jurisdiction they stake out for themselves. An electing taxpayer is required to report any tax-exempt interest, foreign source income, or similar item that is realized and accumulated by a trust if "such accumulated item may ultimately vest in [the electing taxpayer] or his estate and must ultimately vest in such individual, his estate, or his appointees." \(^{34}\) Designed to nullify attempts to insulate such items as tax-exempt interest from the electing taxpayer's return by shifting them to trusts, this new rule is of doubtful effectiveness. Trust indentures seldom provide that specific "items" of gross income shall "vest" in a beneficiary. If an electing taxpayer may receive the net income of a trust, or a fraction or stated amount thereof, or an amount unrelated to the trust's gross or net income, how are we to decide whether it is an "item" specified by the new rule or the trust's other income that is used to pay trust expenses, distributed currently or accumulated for future distribution to other beneficiaries, or accumulated for the electing taxpayer, his estate, or his appointees? Even if this question were answered by a statutory presumption or other rule, the provision itself imposes no direct restrictions on the use of trusts to preserve deductions or other allowances as distinguished from exclusions. Any indirect impact it may have on such arrangements (e.g., the transfer of an oil business, in order to preserve deductions for percentage depletion or intangible drilling costs) is murky at best.

In another effort to prevent the electing taxpayer from taking the benefits of the proposed new system without incurring its burdens, the proposal would nullify section 673(b) (two-year charitable trust), with the result that an electing taxpayer who establishes a trust of less than 10 years duration is governed by the "grantor trust" rule of section 673(a) even though the income is irrevocably dedicated to charity. As pointed out above, the electing taxpayer can preserve the substance of the charitable deduction,

\(^{34}\) Evidently an item is taxable to the electing taxpayer under this rule only if it is in fact accumulated by the trustee, but the language of the proposal is a bit ambiguous on this point.

For trusts of which the electing taxpayer is the grantor, the proposed new rule seems to overlap the coverage of §§ 676-77 of existing law to a large extent, but it does not contain their exceptions for powers to revest income or corpus in the grantor that are not exercisable for ten years, and it also reaches powers exercisable only by an adverse party. As to trusts created by other persons, the proposed rule can be regarded as an expansion of § 678.
even though it is ostensibly denied to him, if he is willing to create a trust with a duration of ten years or more.\textsuperscript{35}

\textbf{THE ELECTING TAXPAYER'S NON-ELECTION YEARS}

Just as the optional character of the simplified tax method will stimulate the shifting of income and deductions from the electing taxpayer to non-electing related taxpayers, so the temporary character of an election will reward the electing taxpayer who can shift some types of income and deductions from election to non-election years. Mindful that personal deductions allowed by present law will be "wasted" if incurred or paid in an election year, the canny taxpayer will endeavor to bunch them into non-election years; and the same strategy will apply to all other items that are disfavored in election years (intangible drilling and development costs, capital gains, foreign income, etc.). While some items are not easily postponed or accelerated, others (e.g., charitable contributions) are quite pliable, and the stakes are sufficiently high for one to predict with confidence that methods will be sought—and found—to shift them to the years in which they will be most "useful."\textsuperscript{36} Conversely, items of ordinary income that will be taxed in any event should be bunched in election years when the low simplified rates will apply, a strategy that can be readily applied to dividends from closely-held corporations, and, without superhuman skills, to some other types of income as well.

The postponement or acceleration of items for tax advantage would not, to be sure, be a new phenomenon; for many years the Internal Revenue Code has rewarded the judicious timing of both personal and business transactions. The taxpayer who has incurred a capital loss may be well advised to sell appreciated property this year rather than next; the percentage limits on the medical expense and charitable contribution deductions can be avoided, to some extent, by proper timing; the optional standard deduction is especially appealing to the taxpayer who can arrange to make his charitable contributions and other deductible payments in even

\textsuperscript{35} \textit{Supra} note 29.

\textsuperscript{36} Thus, a cash basis taxpayer on selling a capital asset can arrange the payment schedule so that he will receive no more than his adjusted basis during election years, postponing receipt of his gain until the election has expired or has been revoked, when the favorable capital gain rate will become applicable. See \textit{supra} at 14, pointing out that the simplified tax method accepts without change the accounting rules of existing law.
years while taking the standard deduction in odd years; and so on. The simplified tax method would alter the odds, however, by increasing the probability that this type of planning will pay off. So far as most other temptations to postpone or accelerate transactions are concerned, the taxpayer must gamble: the best-laid plan may be frustrated by an unexpected gain or loss at the end of the current, or in the following, year. The taxpayer who has filed an election under the simplified tax method, however, cannot lose, and he will almost certainly gain, by postponing to a non-election year any item that cannot be deducted while the election is in force.

Senator Long himself calls attention to the acceleration-postponement threat to the integrity of the simplified tax system, and provides two shields against it. The first is the election’s five-year life. Even if the election were irrevocable for this period, however, it would leave room for a good deal of manipulation at the beginning and end of the period, especially since the taxpayer need not commit himself to an election until three and one-half months after the end of the first taxable year for which it is to be effective. The five-year period shrinks in efficacy still more when we take into account the possibility of a revocation or a change in the Code or regulations narrowing the gap between electing and non-electing taxpayers as a class. As is suggested above, the electing taxpayer will probably not be fenced in for more than two or three years at a time, despite the theoretical five-year term.

The proposal’s second shield against manipulation is the broad authority granted to the Treasury to issue regulations governing the behavior of electing taxpayers. No doubt regulations could be devised that would prevent taxpayers from arbitrarily assigning some income items or deductions to non-election rather than election years, or vice versa (e.g., arranging to pay interest on a residential mortgage every sixth year), where the normal pattern of familiar transactions would have to be distorted to accomplish his

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37 Supra at 8.

38 A third shield, much more specialized, consists of a set of special rules relating to “accumulation distributions” by trusts under § 665(b). In brief, § 1394(f) of the proposal would negate the “relief” provisions of § 665(b), the five-year limit of § 666(a), and part of § 668(a)—in order to discourage the accumulation of trust income in non-electing years for distribution to a beneficiary in an election year. I am indebted to Arthur M. Michaelson, of the New York bar, for the observation that the “relief” provisions that are to be thus eliminated were themselves designed to “simplify” the accumulation rules of Subchapter J, and that the “simplified tax system” will further complicate Subchapter J if one beneficiary of a trust is an electing taxpayer but others are not.
objective. Perhaps—I am speculating, not recommending—the regulations could provide that no item may be deducted in a non-election year unless the taxpayer satisfies the Treasury that tax avoidance was not a principal reason for paying or incurring it in that year rather than in an election year in which it would not have been deductible. Still another possibility is a regulation requiring all deductions to be averaged over the election period and the three years immediately preceding and following that period, with any above-average amounts in the non-election years being disallowed as deductions because of the possibility that they were bunched for a tax avoidance purpose. A set of parallel rules for income might be prescribed to prevent above-average amounts of capital gains, tax-exempt interest, and similar items from being reported in non-election years preceding or following the electing taxpayer’s simplified tax years.

Treasury rules of this type would be unpalatable medicine, but without them the simplified tax method would open a host of opportunities for the very kind of tax “planning” that Senator Long finds objectionable. With such safeguards, however, the glimmer of simplification fades away. A simple tax structure cannot be constructed by digging some holes in the Code and dumping the debris in the regulations.

Retroactive Revocation of the Election

In the 1963 version of the simplified tax proposal, the taxpayer’s right to revoke his election was conditioned on the occurrence of a specified event (substantially disadvantageous change in Code or regulations; permanent disability, bankruptcy discharge, or “other good cause,” in the Treasury’s discretion); and the revocation was to take effect only when made, without retroactive effect. The 1964 version enlarges the taxpayer’s freedom—he may now revoke whenever he wishes—but he is then to be treated “as if he had never made such election.” His tax liability for the prior years of the revoked election’s five-year period must be recomputed by applying the regular tax rates to his taxable income (computed in the normal fashion). To this recomputed liability, an additional tax of five per cent thereof is added, and the difference between this amount and the simplified tax actually paid is either assessed as a deficiency or refunded. Following a retroactive revocation, the usual five-year waiting period must elapse before the taxpayer
may make a new election, unless the Treasury consents to an earlier return to the simplified tax method.

In describing the new provision as a safety valve for the taxpayer who “has suffered unexpected financial reverses,” Senator Long provided no illustrations of its intended operation, but presumably he had in mind the electing taxpayer who wants to return to the regular method of computing his tax liability in order to take advantage of deductions or other allowances that result from or follow “unexpected financial reverses,” and that are not available in computing his simplified tax liability. In assessing this problem, it should be noted that a sharp decline in business income, a net operating loss, or a large capital loss by itself would not ordinarily convert the election into a millstone around the taxpayer’s neck, because these items would be taken into account in computing simplified taxable income. When the electing taxpayer’s income drops to a very low level, however, he may begin to regret his election, because the non-electing low bracket taxpayer has the advantage of lower rates (fourteen to twenty per cent) instead of the flat twenty per cent applicable at the bottom of the simplified tax schedule, and is also entitled to the dependency exemptions and to either his personal deductions or the optional standard deduction.

An example is a married taxpayer who elects to compute his 1966 tax liability under the simplified tax method, but suffers “unexpected financial reverses” in 1967. If we assume that his 1967 simplified taxable income is $8,000 but that his regular taxable income for the same year is $4,000 by reason of personal deductions and dependency exemptions, a return to the regular method of computing his tax liability would produce a 1967 saving of $980, computed as follows:

<table>
<thead>
<tr>
<th>Simplified tax liability</th>
<th>$1,600</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular tax liability (1965 rates)</td>
<td>$620</td>
</tr>
<tr>
<td>Savings</td>
<td>$980</td>
</tr>
</tbody>
</table>

If he exercises his privilege of revoking his election retroactively in order to save $980 in 1967, however, he must recomputed his 1966 liability without the benefit of the election. Assuming that his 1966 simplified taxable income was $100,000 and his tax liability $32,600, and that a recomputation produces taxable income of $80,000 (by reason of non-taxable items, personal deductions, and dependency
exemptions), a revocation of the election will cost $5,452, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular tax liability (taxable income, $80,000, 1965 rates)</td>
<td>$36,240</td>
</tr>
<tr>
<td>Plus: five per cent additional tax</td>
<td>1,812</td>
</tr>
<tr>
<td>Less: simplified tax paid</td>
<td>32,600</td>
</tr>
<tr>
<td>Deficiency</td>
<td>$ 5,452</td>
</tr>
</tbody>
</table>

Thus, a retroactive revocation would cost $5,452 in additional tax for 1966, and would save only $980 for 1967. Even if we assume that the taxpayer’s financial circumstances for 1968–1970 are identical with those for 1967, his potential savings for the four-year period 1967–1970 would be only $3,920 (four times $980)—not enough to justify the retroactive revocation for 1966. A retroactive revocation would be even less appealing if the taxpayer had enjoyed two (or more) years of tax reduction by reason of the election, or if the gap between his simplified tax liability and his “regular” tax liability in those years had been greater than in the example.

A retroactive revocation will become more appealing if we assume that the taxpayer’s 1966 simplified taxable income was $50,000 and his regular taxable income $44,000:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular tax liability (1965 rates)</td>
<td>$14,060</td>
</tr>
<tr>
<td>Plus: five per cent additional tax</td>
<td>703</td>
</tr>
<tr>
<td>Less: simplified tax paid</td>
<td>13,300</td>
</tr>
<tr>
<td>Deficiency</td>
<td>$ 1,463</td>
</tr>
</tbody>
</table>

Even on these revised assumptions regarding the taxpayer’s 1966 income, however, it will take more than one year of post-revocation savings to recoup the deficiency for 1966. If we vary our assumptions to postulate that his circumstances for 1966 and 1967 are as described above for 1966, and his circumstances for 1968–1970 (the remaining three years of the normal five-year election period) are as described for 1967, he would have to pay $2926 (for 1966–1967) in order to save $2940 (for 1968–1970)—a net savings of $14. Quite aside from the pain of paying the deficiency for 1966–1967 before realizing the savings for 1968–1970, and even if the potential savings were much greater, it might be better strategy to refrain from making a retroactive revocation in 1968, in the hope that a disadvantageous change in the Code or regulations will permit a “free” prospective revocation.
If the privilege of revoking the election retroactively is of limited assistance to taxpayers suffering "unexpected financial reverses," its value to electing taxpayers who enjoy unexpected financial success is dramatic. To illustrate: assume that the $100,000 taxpayer described above realizes an unexpected $100,000 long-term capital gain in 1967, in addition to ordinary income of $100,000. For him, the savings in 1967 of a return to the regular tax system would be $24,260:

<table>
<thead>
<tr>
<th>Simplified tax (STI: $200,000)</th>
<th>$22,600</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular tax liability (taxable income, $180,000, of which $100,000 is capital gain)</td>
<td>58,340</td>
</tr>
<tr>
<td>Savings</td>
<td>$24,260</td>
</tr>
</tbody>
</table>

Thus, in a single year, he can more than recoup the cost ($5,452 per year) of revoking his election for four prior years. For the $50,000 taxpayer postulated in the preceding paragraph, an unexpected capital gain of as little as $50,000 will similarly make it profitable for him to revoke an election that has been in effect for four years.39

Aside from a long-term capital gain on a sale of securities, an electing taxpayer who strikes it rich in oil, exercises a stock option when the spread between the option price and the stock's fair market is unexpectedly large, receives a lump sum payment on terminating a "Louis B. Mayer" employment contract, inherits a portfolio of tax exempt bonds, or recovers damages for personal injuries—the list could be easily extended—may save far more on revoking his election than he must pay for the privilege. Even if a taxpayer knew several years in advance that he would engage in such a transaction, he might find it advantageous to elect in order to use the temporary tax savings in his business, repaying it on revoking the election. The investment could well yield a greater

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38a In speaking of taxpayers suffering "unexpected financial reverses," Senator Long offered no specific instances of the intended application of this provision, so I have had to extrapolate from his general statement. I have obviously not exhausted the possibilities with my examples, but they seem to me reasonable tests of the provision in question.

39 His savings for the year in which he realizes a long-term capital gain of $50,000 would be $6,100:

<table>
<thead>
<tr>
<th>Simplified tax liability (STI: $100,000)</th>
<th>$32,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular tax liability (taxable income, $94,000, of which $50,000 is capital gain)</td>
<td>26,500</td>
</tr>
<tr>
<td>Savings</td>
<td>$ 6,100</td>
</tr>
</tbody>
</table>
return than the additional tax of five per cent plus the interest charged on the deficiency upon revocation.\textsuperscript{40}

Less dramatic but more important than elections made solely to be revoked will be elections by taxpayers who hope or expect to receive capital gains or other special items but cannot accurately predict the amount or the year of receipt. It is reasonable to assume that many high-bracket electing taxpayers will find themselves in this position and that the prudent course for many of them would be an election, to be followed by a revocation if and when the facts so fall out as to make it advisable.\textsuperscript{41} The point to be made about these taxpayers, aside from the fact that they have not suffered the "unexpected financial reverses" that are the ostensible reason for allowing elections to be revoked retroactively, is that they will have to reappraise their circumstances every year in order to decide whether to revoke without further delay or not. As time passes, it may become easier to predict the amount of the special item and its year of receipt, and a revocation a year or two before it is received may be cheaper than a last-minute revocation. Moreover, such a taxpayer may be able to postpone or accelerate some types of income and outgo, and his financial strategy will be af-

\textsuperscript{40}For example, the hypothetical taxpayer whose circumstances are described by Senator Long to illustrate the operation of his proposal (Table 8, Case B, 110 Cong. Rec. 23,006 would save about $122,000 by electing the simplified method because his regular liability would be about $603,000 and his simplified liability only $481,000. If he revoked his election a year later, he would have to repay about $162,300 (\$122,000, plus 5% of $603,000, plus 6% on the sum of these amounts). Thus, he would have had the use of $122,000 for one year at a cost of about $40,300. This is not the prime rate, but business men have been known to pay even more than this for money, and like William Zeckendorf, the electing taxpayer might prefer "to be alive at 25% rather than dead at the prime rate." Moreover, on other assumptions, including a longer time span, the annual cost of the temporary tax saving would be lower than in this case.

\textsuperscript{41}Prudence may also suggest an election by a taxpayer with substantial ordinary income (salary, dividends, interest, etc.) who participates in an exchange producing substantial capital gain that arguably qualifies for non-recognition. If the transaction is held to qualify, the simplified tax will be advantageous; otherwise, on learning that his assumption was erroneous, he can revoke his election in order to qualify for the 25% tax ceiling on long-term capital gain applicable to non-electing taxpayers. Once the status of the item is questioned, the taxpayer will have to decide whether to revoke immediately, or to stand his ground and revoke only if and when the item is held to be taxable. If he revokes immediately, and ultimately loses, he will have saved the 5% additional tax for the post-revocation years; but if he wins, his revocation will have lost him the benefit of the simplified tax rate for those same years. On the other hand, if he does not revoke when the item is questioned, he will preserve his right to the simplified tax rate, but at the cost of an additional 5% for the remaining years of the five-year period if a revocation becomes necessary. (Apparently a revocation cannot be reinstated; see infra note 44.) A revocation is evidently possible even if he has unsuccess-

fully litigated the election year; see supra note 13.
fected by the likelihood of a revocation. I detect no net gain for tax simplification here, especially when we also note that in deciding whether and when to revoke, account must be taken of the five-year waiting period that must elapse before a new election may be made.

Retroactive revocations are likely to be especially common among the 250,000 taxpayers in the $10,000-50,000 adjusted gross income class who, according to the Treasury, will elect the simplified tax method. Since an average taxpayer in this category will save only about $350 per year by making the election, a modest change in his economic circumstances will be sufficient to stimulate a revocation—a $5,000 long-term capital gain, casualty loss, medical expense, charitable contribution, tort recovery, interest payment, etc., etc., will often be enough, and in some cases a $1,000 item or even a new dependency exemption may suffice. In a realistic assessment of the revocation procedure, we ought to assume that virtually all of the 250,000 taxpayers in the $10,000-50,000 adjusted gross income class will be on the verge of a revocation at all times; and that this assumption will be equally valid for many of the 55,000 electing taxpayers in the $50,000-100,000 adjusted gross income class, for whom the average annual savings from an election will be about $1,550. It is equally reasonable to assume that many of these taxpayers will fail to retain their records, will be indignant when deductions for prior years are disallowed after a revocation, and will not bless the day they were told that the "simplified tax method" would enable them "to forego the difficulties of record keeping, accounting, and reporting [personal] expenses."

Would the Simplified Tax Simplify?

Because of Senator Long's stress on simplification of the federal income tax system—"it [the proposal] would reverse the trend to an ever-increasing complexity and show our determination to achieve simplification"—I now turn to an evaluation of this claim, which is exemplified by the new terms, "simplified tax method," "simplified tax," and "simplified taxable income." For convenience, I shall discuss separately the effect of the new method on those

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42 Supra note 4.
43 Supra note 4.
44 As I read the proposal, a taxpayer who revokes an election cannot reinstate it on finding that his proof of itemized deductions will not stand up at the administrative level or in court. His plight will be somewhat alleviated, however, if the ceiling on the standard deduction is increased to $2,000, as Senator Long proposes.
who do not elect ("nay-sayers") and on three categories of electing taxpayers ("cake-eaters," "fence-straddlers," and "loyalists").

**Nay-Sayers**

For non-electing taxpayers, of course, the simplified tax method would achieve no simplification; to the contrary, it would introduce into the law a new complexity by requiring the merits of an election to be weighted against its disadvantages. This would not be a matter of simple arithmetic, since a taxpayer for whom the election would not be attractive under existing conditions would want to see whether his affairs could be re-arranged so that an election would become advantageous. His computation, moreover, would be incomplete without an estimate of the cost of keeping the election in effect for part or all of its normal five-year period and, in the alternative, of revoking should it come to be an albatross around his neck. For those who decide after study that the election is not, and cannot be made, more attractive than the non-elective method, the mere existence of the "simplified" alternative would increase the complexity of existing law. Many would be called, but few would be chosen.

How many taxpayers will find it prudent to make the alternative simplified tax calculation, only to decide against an election? In the absence of a more authoritative estimate by the Treasury, I should suppose that most of the 1.2 million taxpayers filing taxable returns with adjusted gross income of $20,000 or more would make a trial calculation. The Treasury estimates, as indicated above, that about 300,000 of these taxpayers would actually elect. When we descend to the $10,000–20,000 adjusted gross income class, the Treasury estimates that only 10,000 of the 5.7 million taxpayers in this category would elect, and no doubt most of the others would not even be within striking distance of an election. Even so, a substantial number of them would have to make the calculation to be sure that they were not passing up a good thing.⁴⁵ All in all, I think a

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⁴⁵ For the 5.6 million married taxpayers in this adjusted gross income class, the simplified tax would ordinarily not be preferable to the "regular" tax. This is because a married taxpayer with $20,000 of adjusted gross income would, at a minimum, be entitled to an optional standard deduction of $2,000 (see supra note 5, re proposed increase in ceiling on standard deduction) and personal exemptions of $1,200, resulting in taxable income of $16,800 and a "regular" tax liability of $3,504 (at 1965 rates). Assuming no other relevant facts, this taxpayer's simplified taxable income would be $18,800 (adjusted gross income of $20,000 less personal exemptions of $1,200), on which the simplified tax liability would be $3,760. In some cases, however, an election would be preferable; for example, if the taxpayer just described was entitled to an alimony deduction.
good case can be made for the proposition that the simplified tax system would require more man-hours of wasted effort by non-electing taxpayers than it would save for electing taxpayers.

Finally, since the simplified tax system does not eliminate any of the substantive provisions of existing law for non-electing taxpayers, they and their tax advisers, as well as the Internal Revenue Service, will continue to be concerned with interpreting and applying these provisions. Not a word of the Code, nor a single ruling, regulation, or judicial decision, will be made obsolete or irrelevant, and few will be much diminished in importance, by the new complexities that are added by the simplified tax method.

CAKE-EATERS

Because the simplified tax method is optional with the taxpayer and binds even the electing taxpayer for a limited period only, it invites him to shift disfavored items to non-election years or to related non-electing taxpayers, while applying the low simplified rates to his residual "simplified taxable income" in election years. I have already described some of the devices that taxpayers may

of $2,000 but to no other personal deductions, his taxable income and "regular" tax liability would remain unchanged, but his simplified taxable income would be reduced to $16,800, on which the simplified tax liability would be $3,360—a savings of $144. Taxpayers with employee business expenses or § 212 investment expenses that are displaced by the optional standard deduction, but allowed in computing simplified taxable income, could also find an election preferable.

For the 260,000 single taxpayers and 115,000 head of household taxpayers in the $10,000–20,000 adjusted gross income class (1962), the threshold for profiting from an election is lower than for married taxpayers. A single taxpayer with $13,000 of adjusted gross income, claiming the standard deduction of $1,300 (assuming an increase in the ceiling, as proposed by Senator Long) and one personal exemption of $600, would incur a tax liability at 1965 rates of $2,542 on taxable income of $11,000. Assuming no other relevant facts, his simplified taxable income would be $12,400 and his simplified tax liability would be $2,480. The savings is small ($62), but it will increase substantially as adjusted gross income rises from $13,000 to $20,000.

In the absence of a more precise estimate by Treasury statisticians, I should not be surprised if as many as five taxpayers would find it prudent to calculate their simplified tax liability for every one who actually made the election. Of course, administrative guidelines could be devised to identify some classes of taxpayers who should not bother to make the alternative calculations, and it may be possible to transfer some responsibilities in this area to IRS computers. Lest it be thought that this task is comparable to announcing that the alternative capital gain calculation of existing law cannot be advantageous to taxpayers with less than $26,000, $38,000, or $53,000 of taxable income (separate, head of household, and joint returns), however, it should be noted that many more factors enter into a comparison of a taxpayer's simplified tax liability with his "regular" liability, at least for the 7.9 million taxpayers with adjusted gross income of $10,000 or more.
employ to eat their cake and have it too.\textsuperscript{46a} Even if the Treasury's protective measures succeed in frustrating some of these efforts, and despite the elimination of whatever deductions and other allowances these taxpayers are unable to postpone, I would not count on a net gain for simplification in this category of taxpayers.

**FENCE-STRADDLERS**

For the reasons set out above,\textsuperscript{46} some taxpayers (including some "cake-eaters") will elect the simplified tax method with little or no intention of adhering to it for the normal five-year period. For such a taxpayer, revocation of the election will have to be debated whenever a change in the Code or Regulations offers him a free choice, and the privilege of revoking retroactively may cause him to reassess his status every year.\textsuperscript{47} If he is foresighted, he will retain the same records to support his itemized deductions as a non-electing taxpayer; but he will have to preserve them for a longer period, because a retroactive revocation of his election may affect years on which the normal three-year statute of limitations has run. These fence-straddlers will benefit from the simplified tax method, but it will simplify nothing for them.

**LOYALISTS**

My final category consists of taxpayers who will elect the simplified tax method with every expectation of keeping their elections in force for the full five-year period, and perhaps indefinitely. A taxpayer is most likely to fall into this category if he enjoys a consistently high level of income (e.g., $50,000 or more) from personal services, but has little or no invested capital that might generate long-term capital gains (and thus stimulate a revocation of the election) or that might be shifted to non-electing related taxpayers.

\textsuperscript{46a} Supra at 19.

\textsuperscript{46} Supra at 26.

\textsuperscript{47} In proposing the 1963 version of the simplified tax method, Senator Long said:

It may be objected that, even for the group affected, the program is not a simplification because taxpayers would have to compare their tax under the present system with the tax under the optional program before deciding whether to elect. Thus two computations of tax would be required where one suffices today. This reasoning overlooks the fact that the election is irrevocable for five years. Once the election is made, the taxpayer would follow the simple system for the next four years without any need for alternative computations.

The premise of an irrevocable election, on which this argument rested, was debatable even in 1963 (\textit{supra} at --), and it was further undermined by the addition in 1964 of the privilege of a retroactive revocation. Despite this, the argument is repeated verbatim in support of the 1964 proposal.
in order to perpetuate tax allowances that he cannot enjoy directly. These taxpayers, and the revenue agents who examine their returns, would not be concerned with deductions for taxes, charitable contributions, medical expenses, etc. for as long as the election remained in effect. To this extent, Senator Long is on solid ground in likening the simplified tax method to the optional standard deduction of existing law.

Viewed in terms of scale, however, the analogy is fallacious. For 1962, the optional standard deduction was employed on 36 million returns. One can hardly overstate the administrative savings that results from eliminating itemized personal deductions from this many returns, most of them filed by low income taxpayers whose records are rudimentary at best. A comparable contribution to simplification would not result, however, from eliminating the itemized deductions of a limited number of “loyalist” taxpayers, most of them at an adjusted gross income level ($100,000 and over) where reasonably accurate records are common and where an audit of the return is likely in any event. The 1964 version of the simplified tax is accompanied, as has been mentioned, by a proposal to increase the minimum standard deduction by $100 (from $300 to $400 for single persons and from $400 to $500 for married taxpayers), and to raise the ceiling on the standard deduction from $1,000 (present law) to $2,000. Either of these recommendations, which would affect 11 and 2.5 million returns respectively, would surely save far more man-hours of record-keeping and calculations for both taxpayers and the government than the simplified tax method, yet their estimated revenue costs are about the same.

Another source of simplification for “loyalists” is the flat fifty per cent rate applicable to simplified taxable income above $50,000 (separate returns) or $100,000 (joint returns), which should serve to alleviate some of the timing problems that are inherent in a progressive rate structure. Before counting our chickens, however, we must note that an acceleration of deductions or postponement of income confers benefits even if the taxpayer’s marginal tax rate

48 I have already explained (supra at 31) why the 250,000 electing taxpayers in the $20,000–50,000 adjusted gross income class cannot be regarded as “loyalists.” Of the 55,000 electing taxpayers in the $50,000–100,000 adjusted gross class, for whom an election will mean an average annual savings of only $1,500 (supra note 4), many will obviously be “cake-eaters” and “fence-straddlers” rather than “loyalists.”

49 Increased minimum standard deduction, $270 million; increased ceiling on standard deduction, $210 million; simplified tax method, $225 million.
remains unchanged, as witness the frequent disputes over the timing of items in corporate returns subject to a flat rate of tax. Moreover, only 8,000 of the estimated 313,000 electing taxpayers will have adjusted gross income of over $100,000, and most of those below this level (few of whom will be "loyalists" in any event), will be subject to a rate schedule that varies from twenty to forty per cent. With this much variation in marginal rates, the timing of items of income and deductions will continue to be important; indeed, much of technical "know-how" in this area had its origin in the 1920's, when the spread from one taxable year to another in the taxpayer's marginal rate was seldom greater than twenty percentage points.

The full inclusion of capital gains in simplified taxable income could contribute to simplification, by reducing disputes over the classification of border-line items and eliminating the incentive to convert ordinary income into capital gain. The optional character of the proposal, however, severely restricts the achievement of the goal, because the receipt of a large long-term capital gain is likely to stimulate the taxpayer to revoke his election, if indeed the expectation of the gain did not keep him from electing at the outset. Moreover, since capital losses incurred by an electing taxpayer can be offset only against capital gains and $1,000 of ordinary income (as under existing law), the proper classification of borderline transactions remains important, and the conversion of ordinary income into capital gain will continue to be advantageous. I see no reason, therefore, why a taxpayer who has elected the simplified tax method should renounce the stimulating and profitable search for long-term capital gains.

Conclusion

In conclusion, despite Senator Long's hope that the simplified tax method will "reduce the premium enjoyed by the taxpayer who has tax lawyers and accountants to show him ways to avoid paying taxes to his federal government," its enactment would unquestionably expand, rather than diminish, the professional opportunities of readers of this periodical. In my opinion, it would rank with the special treatment of capital gains and losses and the separate taxation of corporate income in becoming one of the main structural sources of complexity in the Internal Revenue Code. Senator Long has argued that

a considerable number of taxpayers who will elect the simplified tax plan will spend more time earning money and less
time concocting tax avoidance arrangements, some of which are uneconomical and contrary to public policy, and all of which cause substantial losses in Government revenue.

I am less sure than Senator Long that taxpayers can earn more money if they spend less time on tax avoidance (or vice versa); but if in fact one of these activities can only be carried on at the expense of the other, I would conclude that enactment of the simplified tax system would reduce rather than increase the time devoted to "earning money."

S. 3250, 88th Congress, 2d Session

IN THE SENATE OF THE UNITED STATES

October 2, 1964

Mr. Long of Louisiana introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 to provide an optional simplified tax method, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 1. SHORT TITLE.

This Act may be cited as "The Simplified Tax Method Act of 1964".

SEC. 2. SIMPLIFIED TAX METHOD FOR ELECTING INDIVIDUALS.

(a) In General.—Chapter 1 (relating to normal taxes and surtaxes) is amended by adding at the end thereof the following new subchapter:

"Subchapter U—Election of Simplified Tax Method

"Sec. 1391. Election of simplified tax.
"Sec. 1392. Simplified tax imposed.
"Sec. 1393. Simplified taxable income defined.
"Sec. 1394. Special rules.

"SEC. 1391. ELECTION OF SIMPLIFIED TAX.

"(a) General Rule.—Except as provided in this subsection and subsection (f), an individual may, for any taxable year, elect to
be subject to the simplified tax imposed by section 1392 in lieu of the
tax imposed by section 1 or section 1201. An election under this sec-
tion may not be made by—

‘‘(1) an estate or trust,
‘‘(2) a nonresident alien individual, or
‘‘(3) a married individual, unless his spouse also makes an
election under this section, or has made an election, which is
in effect for such taxable year, and unless such individual and his
spouse have the same taxable year.

‘‘(b) Election.—

‘‘(1) When made.—Except as provided in paragraph (2),
an election under this section for any taxable year shall be made
within the time prescribed by law (not including extensions
thereof) for filing the return for such taxable year.

‘‘(2) Years prior to issuance of regulations.—An election
under this section for any taxable year ending prior to the date
of the first publication of regulations prescribed by the Secretary
or his delegate under section 1394 may be made within 90 days
after such date.

‘‘(3) Manner.—An election under this section shall be made
in such manner as the Secretary or his delegate shall by regula-
tions prescribe.

‘‘(c) Years for which effective.—An election under this
section shall be effective for the taxable year for which it is made
and for each of the four taxable years immediately succeeding
such taxable year, unless, with respect to any such taxable year,
it is revoked under subsection (d) or (e) terminated under sub-
section (f).

‘‘(d) Revocation of election.—An election under this section
may be revoked (at such time and in such manner as the Secretary
or his delegate shall by regulations prescribe) by the taxpayer
for any taxable year with respect to which—

‘‘(1) amendments (made after the date of such election) to
this subtitle or to the regulations prescribed thereunder become
effective, and the Secretary or his delegate determines that a
major portion of the difference (computed without regard to such
amendments) between

‘‘(A) the tax liability of electing taxpayers as a class under
this subchapter, and

‘‘(B) the tax liability of electing taxpayers as a class which
would exist under this chapter but for this subchapter
is eliminated by reason of such amendments; or
"(2) the taxpayer—
"(A) becomes disabled (within the meaning of section 213(g)(3)) and at least 50 percent of his gross income for the 5 taxable years immediately preceding such taxable year consisted of earned income (as defined in section 911(b)); or
"(B) is discharged in bankruptcy.

A revocation under this subsection shall be effective for the taxable year for which made and for all succeeding taxable years.

"(e) Retroactive Revocation of Election.—
"(1) Retroactive Revocation.—An election under this section may be revoked (at such time and in such manner as the Secretary or his delegate shall by regulations prescribe) by the taxpayer for any taxable year.

"(2) Effect of Retroactive Revocation.—In the case of a revocation, under this subsection, of an election, except as provided in paragraphs (3) and (4), the taxpayer shall be treated (under regulations to be prescribed by the Secretary or his delegate) as if he had never made such election.

"(3) Additional Tax.—In the case of a revocation of an election under this subsection, in addition to the tax imposed by section 1 or section 1201, there is imposed for each year for which the election so revoked would have been effective, a tax equal to 5 percent of the tax imposed by section 1 or section 1201.

"(4) Statute of Limitations.—Notwithstanding any law or rule of law—
"(A) any deficiency attributable to a revocation under this subsection may be assessed and
"(B) any claim for refund or credit relating to an overpayment attributable to a revocation under this section may be filed at any time within 3 years of the date on which the revocation is made.

"(f) Termination of Election.—In the case of a married individual, an election under this section shall terminate commencing with any taxable year for which an election under this section is not in effect for his spouse.

"(g) Election After Expiration, Revocation, or Termination of Prior Election.—
"(1) In General.—If a taxpayer has made an election under this section which has expired in accordance with subsection (c), has been revoked under subsection (d) or (3), or has terminated under subsection (f), such taxpayer may not, except as provided
in paragraph (2), make an election under this section for any of the 5 taxable years following the last taxable year for which his prior election was in effect.

"(2) Exceptions.—Notwithstanding paragraph (1)—

"(A) in the case of an election which has expired in accordance with subsection (e), an election under this section may be made for the first taxable year following the last taxable year for which the prior election was in effect; and

"(B) an election under this section may be made for any taxable year if the Secretary or his delegate consents to such election.

"(h) Rules for Determining Marital Status, Etc.—For purposes of this subchapter—

"(1) Marital Status.—Section 143 (relating to determination of marital status) shall apply in determining whether an individual is married for any taxable year.

"(2) Taxable Years of Husband and Wife.—If the taxable years of a husband and wife begin on the same day and end on different days because of the death of either or both, they shall be treated as having the same taxable year. The preceding sentence shall not apply with respect to the surviving spouse if he remarries before the close of his taxable year.

"Sec. 1392. Simplified Tax Imposed.

"(a) Rates of Tax.—A tax is hereby imposed for each taxable year for which an election under section 1391 is in effect, as follows:

"(1) Individuals.—In the case of an individual other than an individual to whom paragraph (2) or (3) applies, the lesser of—

"(A) the tax determined in accordance with the following table:

<table>
<thead>
<tr>
<th>If the taxable income is:</th>
<th>The tax is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $10,000.</td>
<td>20% of the simplified taxable income.</td>
</tr>
<tr>
<td>Over $10,000 but not over $14,000.</td>
<td>$2,000, plus 25% of the excess over $10,000.</td>
</tr>
<tr>
<td>Over $14,000 but not over $18,000.</td>
<td>$3,000, plus 30% of the excess over $14,000.</td>
</tr>
<tr>
<td>Over $18,000 but not over $32,000.</td>
<td>$4,200, plus 35% of the excess over $18,000.</td>
</tr>
<tr>
<td>Over $32,000 but not over $50,000</td>
<td>$9,000, plus 40% of the excess over $32,000.</td>
</tr>
<tr>
<td>Over $50,000.</td>
<td>$16,300, plus 50% of the excess over $50,000.</td>
</tr>
</tbody>
</table>
"(B) a tax on simplified taxable income computed at the rates provided by section 1(a) (relating to rates of tax on individuals).

"(2) Heads of households.—In the case of a head of a household (as defined in section 1(b) (2)) the lesser of—

"(A) the tax determined in accordance with the following table:

<table>
<thead>
<tr>
<th>If the taxable income is:</th>
<th>The tax is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $10,000..............</td>
<td>20% of the simplified taxable income.</td>
</tr>
<tr>
<td>Over $10,000 but not over $14,000..</td>
<td>$2,000, plus 22.5% of the excess over $10,000.</td>
</tr>
<tr>
<td>Over $14,000 but not over $18,000..</td>
<td>$2,900, plus 25.0% of the excess over $14,000.</td>
</tr>
<tr>
<td>Over $18,000 but not over $20,000..</td>
<td>$3,900, plus 27.5% of the excess over $18,000.</td>
</tr>
<tr>
<td>Over $20,000 but not over $28,000..</td>
<td>$4,450, plus 30.0% of the excess over $20,000.</td>
</tr>
<tr>
<td>Over $28,000 but not over $32,000..</td>
<td>$6,850, plus 32.5% of the excess over $28,000.</td>
</tr>
<tr>
<td>Over $32,000 but not over $36,000..</td>
<td>$8,150, plus 35.0% of the excess over $32,000.</td>
</tr>
<tr>
<td>Over $36,000 but not over $50,000..</td>
<td>$9,550, plus 37.5% of the excess over $36,000.</td>
</tr>
<tr>
<td>Over $50,000 but not over $64,000..</td>
<td>$14,800, plus 42.5% of the excess over $50,000.</td>
</tr>
<tr>
<td>Over $64,000 but not over $100,000.</td>
<td>$20,750, plus 45.0% of the excess over $64,000.</td>
</tr>
<tr>
<td>Over $100,000 but not over $150,000</td>
<td>$36,950, plus 50.0% of the excess over $100,000.</td>
</tr>
</tbody>
</table>

"(B) a tax on simplified taxable income computed at the rates provided by section 1(b) (relating to rates of tax on heads of households).

"(3) Married individuals who file joint returns and surviving spouses.—In the case of a husband and wife who file a joint return under section 6013 and in the case of a surviving spouse (as defined in section 2(b)) the lesser of—

"(A) the tax determined in accordance with the following table:
If the taxable income is:                  The tax is:
Not over $20,000..................... 20% of the simplified taxable income.
Over $20,000 but not over $28,000..  $4,000, plus 25% of the excess over $20,000.
Over $28,000 but not over $36,000..  $6,000, plus 30% of the excess over $28,000.
Over $36,000 but not over $64,000..  $8,400, plus 35% of the excess over $36,000.
Over $64,000 but not over $100,000.$18,200, plus 40% of the excess over $64,000.
Over $100,000......................... $32,000, plus 50% of the excess over $100,000.

; or

"(B) a tax on simplified taxable income computed under section 2 (relating to tax in case of joint return or return of surviving spouse).

"(b) CREDITS AGAINST SIMPLIFIED TAX.—For any taxable year with respect to which an election under section 1391 is in effect, no credit against tax shall be allowed under section 35 (relating to partially tax-exempt interest received by individuals) or 37 (relating to retirement income).

"SEC. 1393. SIMPLIFIED TAXABLE INCOME DEFINED.

"(a) IN GENERAL.—For purposes of this subtitle, the term ‘simplified taxable income’ means adjusted gross income (as defined in section 62), increased as provided by subsections (b) and (c), and reduced as provided in subsection (d).

"(b) AMOUNTS TO ADJUSTED GROSS INCOME.—For purposes of subsection (a), adjusted gross income shall be increased by—

"(1) AMOUNTS OTHERWISE EXCLUDED.—Amounts excluded from gross income under part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income), except amounts described in—

. "(A) subsections (a) and (d) of section 101 (relating to proceeds of life insurance contracts),

. "(B) section 102 (relating to gifts and inheritances),

. "(C) section 108 (relating to income from discharge of indebtedness), and

. "(D) section 111 (relating to recovery of bad debts, prior taxes, and delinquency amounts).

"(2) INCOME FROM SOURCES OUTSIDE THE UNITED STATES, ETC.—Amounts excluded from gross income under—
“(A) sections 893 (relating to compensation of employees of foreign governments), 911 (relating to earned income from sources without the United States), 912 (relating to exemption for certain allowances received from the United States), 931 (relating to income from sources within possessions of the United States), and 943 (relating to exclusion of dividends to residents of Formosa or Hong Kong), and

“(B) any treaty of the United States (notwithstanding section 894, relating to income exempt under treaty).

“(3) SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS.—Two-thirds of all amounts received as a pension or annuity under title II of the Social Security Act or under the Railroad Retirement Acts of 1935 or 1937.

“(4) UNEMPLOYMENT BENEFITS.—Amounts received from a State or a political subdivision thereof, or from the United States, on account of unemployment.

“(5) CONTRIBUTIONS TO EMPLOYEES’ TRUST, ETC.—Contributions, described in sections 403(b) (relating to taxability of beneficiaries under certain annuities), 404(a) (relating to general rule for deduction for contributions of an employer to an employees’ trust, etc.), 404(b) (relating to method of contribution, etc., having the effect of a plan), and 405(c) (relating to deduction for contributions to bond purchase plans), made on behalf of the taxpayer and not otherwise included in gross income, but only to the extent that the taxpayer’s rights to or derived from such contributions are nonforfeitable during his taxable year. For purposes of this paragraph, the Secretary or his delegate may by regulations prescribe that contingencies which are not substantial shall not be taken into account in determining whether an employee’s rights are nonforfeitable. This paragraph shall not apply to contributions made on behalf of a taxpayer who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).

“(6) SECURITIES OF THE EMPLOYER CORPORATION.—Amounts excluded from income under the second sentence of section 402(a)(1) (relating to general rule for taxability of beneficiary of exempt trust) or the second sentence of section 402(a)(2) (relating to capital gains treatment for certain distributions).

“(7) EXERCISE OF CERTAIN STOCK OPTIONS.—In the case of the transfer of a share of stock to a taxpayer pursuant to his exercise, during the taxable year, of an option which meets the requirements of section 422(a) (relating to general rule for
qualified stock options), 423(a) (relating to general rule for employee stock purchase plans), or 424(a) (relating to general rule for restricted stock options), an amount equal to the excess of the fair market value of the share so transferred over the price paid under such option for such share.

“(8) Group-term life insurance.—Amounts equal to the cost (determined on the basis of uniform premiums, computed on the basis of 5-year age brackets, under regulations prescribed by the Secretary or his delegate) of group-term life insurance on the life of the taxpayer provided for part or all of the taxable year under a policy (or policies) carried directly or indirectly by the taxpayer’s employer (or employers).

“(c) Deductions Denied.—For purposes of subsection (a), adjusted gross income shall be increased by an amount equal to the deductions allowed under—

“(1) Taxes on or measured by net income.—Sections 162 (relating to trade or business expenses), 164 (relating to a deduction for taxes), and 212 (relating to expenses for the production of income), for any State, local, or foreign tax on or measured by net income.

“(2) Circulation expenditures.—Section 173 (relating to circulation expenditures).

“(3) Agricultural expenditures.—Sections 175 (relating to soil and water conservation expenditures), 180 (relating to expenditures by farmers for fertilizer, etc.), and 182 (relating to expenditures by farmers for clearing land).

“(4) Natural resources.—Sections 263(c) (relating to intangible drilling and development costs in the case of oil and gas wells), 613 (relating to percentage depletion), 615 (relating to exploration expenditures), and 616 (relating to development expenditures).

“(5) Self-employed individuals.—Sections 404 (relating to deduction for contributions of an employer to an employee’s trust, etc.), and 405(c) (relating to deduction for contributions to bond purchase plans), to the extent attributable to contributions made on behalf of an individual who is an employee within the meaning of section 401(c) (1) (relating to self-employed individuals).

“(6) Capital gains.—Section 1202 (relating to deduction for capital gains).

“(d) Deductions Allowed.—For purposes of subsection (a),
adjusted gross income shall (except as otherwise provided in sub-
section (e)) be reduced by an amount equal to—

"(1) PERSONAL EXEMPTIONS.—The deductions allowed by sec-
tion 151 (relating to allowance of deductions for personal exemp-
tions), other than the additional deductions for age and blindness
allowed by subsections (c) and (d) of such section.

"(2) TRADE AND BUSINESS EXPENSES OF EMPLOYEES.—The deduc-
tions allowed by this chapter (other than by part VII of sub-
chapter B, relating to additional itemized deductions for individ-
uals) which are attributable to a trade or business which consists
of the performance of services by the taxpayer as an employee.

"(3) EXPENSES FOR PRODUCTION OF INCOME.—The deductions
allowed by section 212 (relating to expenses for production of
income).

"(4) ALIMONY, ETC., PAYMENTS.—The deductions allowed by
section 215 (relating to alimony, etc., payments).

"(5) DEDUCTIONS ALLOCABLE TO ITEMS REQUIRED TO BE INCLUDED
IN GROSS INCOME.—The deductions allocable to items required to
be added to adjusted gross income under subsection (b), to the
extent that such amounts would be allowed as deductions but for
the fact that such items were not otherwise included in gross
income.

"(e) ITEMS NOT TO BE TAKEN INTO ACCOUNT MORE THAN ONCE.—
Nothing in this section shall permit the same item to be deducted
more than once or included in income more than once.

"(f) CROSS-REFERENCES.—

"(1) For special provisions relating to contributions to em-
ployees' trusts, etc., see section 407.

"(2) For special provisions relating to stock options, see section
425(b).

"(3) For special provisions relating to trusts, see section 679.

"SEC. 1394. SPECIAL RULES.

"(a) REGULATIONS TO PREVENT AVOIDANCE OF TAX.—The Secre-
tary or his delegate shall prescribe such regulations as he may
demean necessary in order that the income tax liability of any tax-
payer who makes an election under section 1391, before, during,
and after the period for which the election is effective, may be
returned, determined, computed, assessed, collected, and adjusted,
in such manner as clearly to reflect the income tax liability of such
taxpayer and the various factors necessary for the determination
of such liability, and in order to prevent avoidance of such tax
liability. Such regulations may provide for the distribution, apportionment, or allocation of gross income, exclusions, deductions, credits, allowances, and items described in section 1393 between or among a taxpayer who has made an election under this section and any other person or persons. A taxpayer who makes an election under section 1391 shall be considered to have consented to the regulations under this section which are in effect on the date of such election.

"(b) Certain Provisions Inapplicable.—For any taxable year, for which an election under section 1391 is in effect, the following provisions shall not apply:

"(1) Section 72(n) (2) (relating to limitation of tax in case of certain distributions with respect to contributions by self-employed individuals).

"(2) Section 170(b) (5) (relating to carryover of certain excess charitable contributions).

"(3) Section 632 (relating to sale of oil or gas properties).

"(4) Section 673 (b) (relating to exception where trust income is payable to charitable beneficiaries).

"(5) Section 1111 (relating to distribution of stock pursuant to order enforcing the antitrust laws).

"(6) Section 1201 (b) (relating to alternative tax on capital gains).

"(7) Section 1347 (relating to claims against the United States, etc.).

"(c) Adjustments to Basis.—Notwithstanding any provision of section 1016 (relating to adjustments to basis) and notwithstanding any election made under this title, proper adjustment in respect of property shall, under regulations prescribed by the Secretary or his delegate, be made with respect to amounts described in section 1393.

"(d) Penalties Applicable to Certain Distributions.—Section 72(m) (5) (relating to penalties applicable to certain amounts received by owner-employees) shall be applied as if this subchapter had not been enacted.

"(e) Taxable Income.—With respect to any taxable year for which an election under section 1391 is in effect, the term 'taxable income' wherever used in this title shall be read as 'simplified taxable income', unless the context otherwise requires.

"(f) Certain Trusts.—With respect to any taxable year for which an election under section 1391 is in effect—
“(1) paragraphs (1), (2), (3), and (4) of section 665(b) (relating to accumulation distributions of trusts, etc.) shall not apply,

“(2) section 666(a) (relating to amount allocated in the case of accumulation distribution) shall apply to the preceding taxable years of a trust described in section 666(a) without regard to any provision of such section which would (but for this paragraph) limit its application to the 5 preceding taxable years, and

“(3) the next to the last sentence of section 666(a) (relating to amounts treated as received in prior taxable years) shall not apply.

“(g) Income Averaging.—

“(1) In general.—The tax imposed by section 1302 shall, in case of a taxpayer who so chooses, be limited to an amount determined in accordance with the principles of part I (relating to income averaging) of subchapter Q, provided that—

“(A) The income of a year for which an election under section 1391 is in effect shall not be averaged with the income of a year for which such an election is not in effect;

“(B) Notwithstanding section 1302(e)(2) (relating to the definition of base period), if an election under section 1391 is in effect for the computation year, the base period shall be the immediately preceding taxable years (not in excess of four) for which an election under section 1391 was in effect; and

“(C) The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section.

“(2) Eligible individuals.—For any taxable year for which an election under section 1391 is in effect and for the four immediately succeeding taxable years, a taxpayer shall not be an eligible individual within the meaning of section 1303 (relating to individuals eligible for income averaging) unless he consents, at the time and in the manner prescribed by regulations, to the regulations under paragraph (1)(C) of this subsection.

“(h) Cross Reference.—For extension of statute of limitations in certain cases, see sections 6501(k) and 6511(d)(5).”

(b) Contributions to Employees’ Trusts, etc.—

(1) In general.—Part I of subchapter D of chapter 1 (relating to pension, profit sharing, stock bonus plans, etc.) is amended by adding after section 407 the following new section:
"SEC. 408. SPECIAL RULE RELATING TO CONTRIBUTIONS FOR EMPLOYEES WHO HAVE ELECTED SIMPLIFIED TAX METHOD.

"(a) IN GENERAL.—Notwithstanding any other provision of this part, an employee shall include (under regulations prescribed by the Secretary or his delegate) in his gross income for the taxable year contributions which are—

"(1) described in sections 403(b), 404(a), 404(b), and 405(c),

"(2) made on his behalf in any taxable year for which an election made by him under section 1391 (relating to election of simplified tax) is in effect, and

"(3) not previously included in his gross income, but only to the extent that his rights to or derived from such contributions become nonforfeitable during the taxable year. For purposes of this section, the Secretary or his delegate may by regulations prescribe that contingencies which are not substantial shall not be taken into account in determining whether an employee’s rights are or become nonforfeitable during the taxable year.

"(b) CROSS REFERENCE.—

“For treatment of contributions nonforfeitable when made, see section 1393(b)(5).”

(2) CLERICAL AMENDMENT.—The table of sections for part I of subchapter D of chapter 1 is amended by adding at the end thereof the following:

“Sec. 408. Special rule relating to contributions for employees who have elected simplified tax method.”

(c) CERTAIN STOCK OPTIONS.—Section 425 (relating to definitions and special rules) is amended by redesignating subsection (j) as subsection (k) and inserting after subsection (i) the following new subsection:

(j) SPECIAL RULE FOR EMPLOYEES WHO HAVE ELECTED UNDER SECTION 1391.—Section 421(a)(1) shall not apply to any option granted to the taxpayer during a taxable year for which an election by him under section 1391 (relating to election of simplified tax) is in effect.”

(d) ACCUMULATING TRUSTS.—

(1) IN GENERAL.—Subpart E of part I of subchapter J of chapter 1 (relating to grantors and others treated as substantial owners) is amended by adding at the end thereof the following new section:
"SEC. 679. INDIVIDUAL ELECTING SIMPLIFIED TAX METHOD TREATED AS SUBSTANTIAL OWNER.

"(a) General Rule.—An individual for whom an election under section 1391 (relating to election of simplified tax) is in effect for the taxable year shall be treated as the owner of any portion of a trust in respect of which, for such taxable year, there may be accumulated any item of gross income or any item required to be added to adjusted gross income under section 1393(b) (relating to additions to adjusted gross income), if such accumulated item may ultimately vest in such individual or his estate and must ultimately vest in such individual, his estate, or his appointees.

"(b) Special Rules.—For purposes of subsection (a)—

"(1) The term ‘appointees’ includes beneficiaries designated in the trust instrument, legatees, persons appointed by will, and persons who take in default of an appointment.

"(2) The Secretary or his delegate may provide by regulations that contingencies which are not substantial shall not be taken into account.

"(c) Exception Where Grantor or Person Other Than Grantor Is Taxable.—Subsection (a) shall not apply if the grantor of the trust is otherwise treated as the owner under section 671 to 677, inclusive, or if a person other than the grantor is otherwise treated as the owner under section 678.”

(2) Clerical Amendment.—The table of sections for subpart E of part I of subchapter J of chapter 1 is amended by adding at the end thereof the following:

“Sec. 679. Individual electing simplified tax method treated as substantial owner.”

(e) Income From an Employment.—Paragraph (2) of section 232(g) (relating to income from employment) of the Revenue Act of 1964 is amended by adding at the end thereof the following new sentence: “A taxpayer may not elect under this paragraph for any taxable year for which an election by him under section 1391 (relating to election of simplified tax) is in effect.”

(f) Statute of Limitations Extended.—

(1) Limitations on Assessment.—Section 6501 (relating to limitations on assessment and collection) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

“(k) Taxpayers Electing Under Section 1391.—In the case
of a deficiency attributable to the application of regulations under section 1394(a) (relating to regulations to prevent avoidance of tax, etc.), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the last taxable year for which the election by the taxpayer under section 1391 (relating to election of simplified tax) is in effect may be assessed.’’

(2) LIMITATIONS ON CREDIT OR REFUND.—Section 6511(d) (relating to special rules applicable to income taxes) is amended by adding at the end thereof the following new paragraph:

‘‘(5) SPECIAL PERIOD OF LIMITATIONS WITH RESPECT TO TAXPAYERS ELECTING UNDER SECTION 1391.—If the claim for credit or refund relates to an overpayment attributable to the application of regulations under section 1394(a) (relating to regulations to prevent avoidance of tax), in lieu of the 3-year period of limitations prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month following the end of last taxable year for which the election by the taxpayer under section 1391 (relating to election of simplified tax) is in effect.’’

(g) NONSEPARABILITY OF PROVISIONS.—Notwithstanding section 7852(a) (relating to separability clause), if any provision of the amendments made by this section, or the application thereof to any person or circumstance, is held invalid on constitutional grounds by the Supreme Court of the United States, the amendments made by this section shall have no force or effect, and the provisions of the Internal Revenue Code of 1954 shall apply as if this section had not been enacted.

(h) TECHNICAL AMENDMENTS.—

(1) The table of subchapters for chapter 1 is amended by adding at the end thereof the following:

‘‘SUBCHAPTER U. Election of Simplified Tax Method.’’

(2) Section 891 (relating to doubling of rates of tax on citizens and corporations of certain foreign countries) is amended by striking out ‘‘and 881’’ and inserting in lieu thereof ‘‘881, and 1392’’.

‘‘SEC. 3. INCREASE OF LIMITATION ON STANDARD DEDUCTION.

The second sentence of section 141(a) (relating to standard deduction) is amended to read as follows: ‘‘The standard deduction shall not exceed $2,000, except that in the case of a separate
return by a married individual the standard deduction shall not exceed $1,000."

"SEC. 4. MINIMUM STANDARD DEDUCTION.

Paragraph (2) of section 141(c) (relating to minimum standard deduction) is amended to read as follows:

"(2) (A) $300, in the case of a joint return of a husband and wife under section 6013,

"(B) $300, in the case of a return of an individual who is not married, or

"(C) $150, in the case of a separate return by a married individual."

"SEC. 5. EFFECTIVE DATE.

The amendments made by this Act shall apply to taxable years beginning after December 31, 1964."