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*Symposium: Lingering Tax Issues for the Twenty-First Century*

### Current Tax Policy Issues

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## Symposium Issue

### Foreword

#### CURRENT TAX POLICY ISSUES

John J. Potts<sup>1</sup>

Societies build temples, wage wars, and provide for the common good by common means. They always have. Whether they choose wisely or poorly the gods they worship, the enemies they kill, or the framework of societal largess, the societies' activities are financed with property taken from economically productive members of society; the temples, the wars, and the "common good" are financed with taxes.

We tithe to the government, which runs hospitals, feeds and clothes the poor, and otherwise performs functions some associate with religion. We are inculcated with the values of the state religion—civic values. American temples are architectural monuments of ancient proportion and inspiration. Who can look at the Supreme Court Building without thinking first of the architecture of an ANCIENT capitol?

Our wars are of such epic proportion that we do not call war those involving under a million men—at least not officially. If the nonwar does not last for years, we do not give it much attention in our tax system, so vast are our revenues.

In this time of prosperity and peace, a technological renaissance continually amazes us, and the longest bull market in history has yet to

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<sup>1</sup> Professor of law, Valparaiso University School of Law. B.A., University of New Mexico, 1969; J.D., Boston College Law School, 1974; M.S., Northeastern University, 1975. Member of the New Mexico Bar. I thank my colleague, Professor Frederick Frey, of the Valparaiso University Art Department, and Christopher Grabarek, Esq., a litigator with Spangler, Jennings and Dougherty, P.C., of Valparaiso, Indiana for editorial comments on a draft of this article.

run its course. The budget news is of surpluses, the very existence of which is controverted. We debate what to do with money we may not have.

In the background, the golden goose hums along, noting the eggs taken from her owners but putting her energy into laying the eggs. Even issues of life and death do not concern us unless they involve handguns or events far, far away. We are fat.

The economy is thought to be helped or hurt by certain federal government policies. A principle instrument of United States federal policy in economic and in other matters is federal income taxation law, encapsulated in the popular mind in the Internal Revenue Code.<sup>2</sup>

Pax Americana allowed the 50% marginal tax bracket to be lowered to 28%. Even an increase from 28% to approximately 40% did not stop the economic engine. After all, 90% is a living memory, 70% a common memory.

Policy is involved merely in the decisions to tax, to tax income, to apply higher rates to higher incomes, and to do so at today's particular rates. But policy decisions are involved in a great many more aspects of tax law.

We tax some income but not all. We give special deductions to some but not to all. We allow deductions more rapidly than economically realistic, in order to cause income to time-travel into the future—a delay in taxation commonly being viewed as good. We have inconsistent concepts of the appropriate taxpaying unit. We discuss when income should be taxed. As a result we use crude mechanisms to tax different categories of income differently (due to the time value of money). And whether we go one way or the other we call it reform.

Little in the American experience has not been affected by taxation. Tax policy has crept into facets of industrial and personal activity one would have liked to see escape government attention. The apparatus of special treatment overlaid on the revenue-raising provisions is vast, contributing mightily to code complexity. How even to look at the result is not clear to all. Is a subsidy being given to those who pay less because

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<sup>2</sup> A popular legal speaker in New Mexico in the 1970's called it the Infernal Revenue Code. He captured a popular sentiment.

of a tax policy provision? Or can being allowed to keep more of your own money ever accurately be called a subsidy?

A comprehensive review of all tax policy issues would be endlessly interesting and, unfortunately, endless. Only a few can be addressed here, but they are addressed exceedingly well.

Four articles make their way to you today. Professor Stephen Cohen opposes a flat tax alternative to the present progressive income tax rate structure because he believes a flat tax is really a consumption tax. That would make it regressive in relation to income, not flat (neutral). Professor Marcus Schoenfeld explores the concepts of "dependent" and of "support" in connection with the effect of the tax system on indigents, a newly popular subject. Professor Clarrisa Potter addresses limited taxation of income before realization, and provides her own interesting appraisal. Messrs. McIntyre and McIntyre investigate the marriage penalty, its nature and dimensions, and propose a way out of the problem.

*The Vanishing Case For Flat Tax Reform: Growth, Inequality, Savings,  
And Simplification*

Professor Stephen B. Cohen, of Georgetown Law Center, begins the symposium with a contribution to flat tax debate not yet heard in the public dialogue. A flat income tax is not a flat income tax at all since it is not an income tax. It is a consumption tax. It seems it would therefore be a regressive income tax in flat tax clothing.

Public discussion of the flat tax is popularly understood to mean that the progressive rate structure of the present Internal Revenue Code (in which tax rates go up as income goes up) will be made dramatically less progressive—relatively flat. So understood, the result could not be a consumption tax any more than could the present arrangement. In tax parlance, the tax rate structure would change from progressive to neutral (with some variation at the low end to avoid taxing people with very low income and with accommodation for family circumstance and family size). Thus, the flat tax would retain some progressivity but would be relatively flat. And the rate would be lower than it is at the top today. With lower rates there could be some rollback in the many exceptions that provide relief from today's rates, much as occurred in 1986.

The present tax is not really on income, but on the code's and the Supreme Court's idea of what income ought to be taxed—taxable income.

The definition of taxable income would change a bit, due to the rollback in special exceptions, but the changes would make taxable income closer to economic income. The present progressive tax on income would become a relatively neutral tax and would be every bit as much a tax on income, and perhaps more so.

I believe this is the popular perception. It is certainly a possible proposal. Professor Cohen maintains that this is not what is meant by certain important proponents of the flat tax.

In an effort to encourage savings, money invested would be allowed as a deduction. Only taxable income not invested remains taxable income. In other words, taxable income is that income that is consumed. A person with no taxable income who consumes out of past savings, however, would not pay the income tax. This helps since the tax must be on income to pass muster under the 16th Amendment, with consumption as the measure of the portion of income to be taxed. But if men are taxed on going out of the house only if they have red hair, are they taxed on going out or on having red hair? The Pollock court may have to be reconvened for a post 16th Amendment session.

Professor Cohen unabashedly opposes the flat tax proposal with which he deals, although he maintains objectivity. Efforts were made to include an article supporting the flat tax. Those efforts were unsuccessful.

*The Tax Concepts of "Dependent" And "Support": How They Impact On "Tax Indigents"*

Professor Marcus Schoenfeld, of Villanova University School of Law, provides comprehensive insight into the meaning of the tax concepts of "dependent" and "support" and the role they play in federal tax law. He includes in his discussion analysis of the most recent expansion in that role. He is persuasive that these concepts have a moderately pervasive significance for the poor. In this and other respects, his article furthers recent discussion of the impact of tax law on the poor. The article is written from a tax clinic perspective. It provides interesting information about one clinic's experience in representing tax indigents while also providing information about recent legislation encouraging such clinics.

"Tax indigent," the article reveals, has a meaning that raises a question: Is a tax indigent really an indigent at all? Of course some are, but some, the article implies, are not. I have a vivid memory of a

particular tax client to whom I provided free representation. There were special reasons for not charging, but indigency was not one of them. The amount at issue was under a thousand dollars. A lawyer cannot economically spend much time on such a matter even if the client is wealthy. The lawyer will advise the client to compromise the matter or to capitulate before running up a legal bill in excess of the amount at issue. My client was not paying me and something very interesting resulted: my client was unwilling to compromise. He had no incentive to do so. Why appraise the merits of a case, with due regard for the amount at issue, if the hired gun is free and you have always wanted to beat up the IRS?

The incentive of being able to save money in legal fees cannot be given to the indigent. We may wish to be cautious, however, in removing this incentive from those who should be proud to be able to bear it.

*Mark-To-Market Taxation As The Way To Save The Income Tax—A Former Administrator's View*

Professor Clarrisa Potter, of Georgetown University Law Center, addresses herself to broadening of the tax base by taxation of mere appreciation in value. Her explanation of what might be done, her conclusion, and the reasons for it are most interesting.

In this article, Professor Potter brings an insider's view to bear on an esoteric subject. This article brings a serious, sophisticated understanding to bear on a subject of unusual policy importance and factual complexity.

In one article we find securities, taxation of mere appreciation, and also brief comment on the flat tax. All in all, although not the article's purpose, it provides a valuable critique of our present tax system. The possibility of taxation of mere appreciation in value (realization would not be necessary) in the case of certain limited types of property, is balanced by presentation of the downside of the ideas.

*Fixing The "Marriage Penalty" Problem*

Robert S. McIntyre and Michael J. McIntyre present a probing analysis of a perennial problem. In addressing the marriage tax penalty, and how to solve it, they may be dealing with an old problem but they do so in a new way.

The amount of the marriage penalty, which will be found in the article, may not seem large unless you are paying it, and perhaps not even then. But the cumulative effect across all affected couples is very large.

Dollars, however, do not tell the whole story. What does it say about a government that penalizes those who honor the basic unit of society, a natural unit preceding the state in time and in right?

The article presents a comprehensive analysis of a complex problem. Innovative in approach, the article shows that the true economic nature of the problem is quite different from the common perception. The insightful solution proposed is drawn from our own tax history, in which, beginning in 1948, we used to tax each married individual as if he or she were single and earned half the total income. Interestingly, this was the effect even earlier in the eight traditional community property states, whose world view of marital property law regimes derives from southern rather than northern Europe.

This article suffers the benefit of economic data and analysis, not common in law review articles. And it makes a persuasive case.

The diversity of the policy issues addressed in these four articles and their significance in our nation's economic life suggest the breadth and importance of taxation in the United States today. Taken together, the four articles are both informative and provocative.