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INTRODUCTION

"Tax reform." The very words arouse a range of emotions, from evangelical zeal to hopeless despair to bemused resignation. Whatever the response, tax reform has been part of our politics since Congress enacted the first modern federal personal income tax in 1913. Volumes have been written on the problems of the tax system and on what tax reform should accomplish.[1] Still more has been written on the failures of the reform process.[2]

Relatively little analysis of the *rate* of tax reform has been done, however.[3] This Article shows that the rate of tax reform has increased during the 1970s and 1980s, culminating in the much-ballyhooed Tax Reform Act of 1986,[4] and gives some reasons for the acceleration. Of the various explanations for the recent acceleration in tax reform, most are rooted in circumstances exogenous to the legislative process, such as changing economic conditions. This Article presents a different model, one concentrating on endogenous changes in the lawmaking process itself.

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1. For a comprehensive listing of works, see Nacev, *Special Report: A Bibliography of the Literature on Tax Policy,* 30 TAX NOTES 1019 (1986) and updates.

2. *Id.*

3. For a notable exception, see J. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 67-244 (1985). The following outline of the history of federal tax legislation since 1913 is taken from Witte's study.

4. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085.

This Article's model rests on the notion that tax legislation is a contract. Status as a legislator confers on a senator or representative the legal authority to help or hurt private interests through taxation. In exchange for being helped, or for not being hurt, private interests will compensate legislators. Through lobbyists and political action committees, private interests furnish consideration for the exchange in many forms, including sizable sums of money paid to politicians for campaign and even personal use.

The increasing rate of tax change represents a shift from longer- to shorter-term contracts. This Article explains the increasing preference for short-term legislative deals as a function of changes in the legislative structure and of increases in the number of private interests willing to bargain for legislative favors. It must be emphasized that no one theory can explain all aspects of tax reform. The model advanced here is not intended to discredit all other theories, nor does it explain all of the enactment process. Instead, the model presents a fresh perspective that explains, at least in part, the accelerating rate of tax legislation.

Part I of the Article briefly recounts the history of the federal income tax and documents the trend of increasing tax legislation. After reviewing the traditional theory of taxation, Part II sets forth a contractual model of tax legislation that offers a different view of the legislative process. Part III then applies the contractual model to explain the acceleration of tax legislation in recent years. Finally, Part IV considers the Tax Reform Act of 1986 in light of the model. The Article concludes with some thoughts on the implications of the contract model for the durability of the recent changes.

I. THE RATE OF TAX LEGISLATION

A. History of the Federal Income Tax

The current federal individual income tax began with a modest bill passed in 1913 that set a top marginal rate of seven percent on taxable income over $500,000[5] and supplemented the corporate income tax that had been enacted four years earlier.[6] Almost immediately, political incrementalism began to ensure

5. Tariff Act of 1913, ch. 16, § II(A)(1), (2), 38 Stat. 114, 166. *See also* J. WITTE, *supra* note 3, at 78.

6. *See* Tariff Act of 1909, ch. 6, § 38, 36 Stat. 11, 112. *See also* J. WITTE, *supra* note 3, at 74-75. In 1908, the Roosevelt administration proposed both an inheritance tax and an income tax. Despite opposition by House Speaker Can-

growth in the income tax. From 1917 through 1920, Congress decreased exemptions and increased rates on both individual and corporate income taxes to finance the war.[7] By 1920, the income tax had replaced the excise tax as the United States's dominant revenue source, accounting for approximately sixty percent of all tax receipts.[8]

In the 1920s, however, Congress de-emphasized the income tax. The Revenue Acts of 1921 and 1924 repealed the excess profits tax and lowered income tax rates, although the acts raised the estate tax and added a gift tax to backstop it.[9] Further tax cuts followed in 1926 and 1928, including decreases in the estate tax and corporate tax rates.[10]

The 1930s altered the direction of tax policy. The Revenue Act of 1932 returned the maximum individual surtax rate to the 1922 level of fifty-five percent and increased corporate rates as well.[11] The Revenue Act of 1934, while raising rates again, focused primarily on perceived administrative shortcomings, capital gains provisions, and a new tax on personal holding companies.[12] From 1934 to 1945, the Roosevelt administration continued its attack on what it perceived to be "an unjust concentration of wealth and economic power."[13] During that period, Congress passed at least one revenue bill every year.[14]

In the Forties, the income tax became less an imposition on

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non and a Senate that consistently resisted the income tax in favor of high tariffs, both branches adopted the corporate income tax in 1909. *Id.* at 74.

7. During this period maximum rates jumped from 7% to 77%. *Id.* at 84-87.

8. *Id.* at 87.

9. *Id.* at 90-93.

10. *Id.* at 93-95.

11. *Id.* at 97.

12. *See id.* at 98-99.

13. A Message to Congress on Tax Revision (June 19, 1935), *reprinted in* 4 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 270, 271 (S. Rosenman ed. 1938).

14. J. WITTE, *supra* note 3, at 100-08. In 1935, Congress raised corporate, estate and gift, and surtax rates for individuals. *Id.* at 100-01. Undistributed corporate earnings bore the brunt of the 1936 changes, although corporate rates rose across the board. *Id.* at 102-03. The Revenue Act of 1938 reduced the scope of the undistributed corporate profits tax and liberalized the capital gains provisions. *Id.* at 105-06. That trend continued with the elimination of the undistributed profits tax and the reduction of corporate capital gains taxes in the Revenue Act of 1939. *Id.* at 107. Throughout the period, the tax system also succumbed to increasing compartmentalization. *Id.* at 108. Separate tax provisions dealing with partnerships, extractive industries, life insurance companies, and domestic and foreign personal holding companies emerged during this period. *Id.*

the elite, instead raising revenue from all conceivable sources for rearmament. In 1940, Congress imposed an excess profits tax on corporations and added a ten percent surcharge for individuals with income between $6,000 and $100,000.[15] Further rate increases marked the Revenue Acts of 1941 and 1942.[16] More important, with the Revenue Act of 1942, the personal income tax reached more than twenty-eight million taxpayers, as compared to thirteen million covered before.[17] With millions of new Americans on the tax rolls, Congress moved in 1944 to "simplify" the tax system by enacting a graduated withholding system, tax tables, and the standard deduction.[18]

Following the war, Congress reduced taxes in 1946 and 1948.[19] In 1950, Congress reenacted an excess profits tax to help fund the Korean war.[20] A year later, the 1951 bill raised overall rates for individuals and corporations, but also provided many deductions and credits that lowered rates for many groups.[21]

For the most part, the Eisenhower years were a period of quiescence for tax legislation, with one large exception. In 1954, Congress reorganized the tax code for the first time since 1913. The bill was long and complex, adding provisions affecting a variety of individuals and organizations.[22] After enactment of the 1954 Internal Revenue Code, however, Congress restrained itself until 1962.

President Kennedy set the stage for the Revenue Act of

15. *Id.* at 111.
16. *See id.* at 112-17.
17. *Id.* at 117.
18. *Id.* at 122-23.
19. *See id.* at 131-35. The 1946 tax legislation passed easily. A stubborn Truman administration, however, defeated a subsequent tax reduction proposal throughout the following two years. Congress lacked the necessary vote to override three executive vetoes. In 1948, however, Congress overrode a presidential veto and thus further reduced taxes. *Id.*
20. *Id.* at 137-40. During the course of enactment, Congress weakened the provisions "for fast-growing and depressed industries, for companies with 'base-period abnormalities' (the profit base was 1946-1949); new corporations; regulated corporations; mining and strategic mineral income; timber, natural gas, shipbuilders, and railroads; and, finally, airlines carrying air mail." *Id.* at 139.
21. *Id.* at 142-43. Groups affected included, for example, the real estate industry, mining companies, farmers, ranchers, the fishing industry, veterans, United States taxpayers living abroad, and the elderly.
22. *Id.* at 148-50. Groups affected included child care recipients, social security recipients, unemployment compensation recipients, corporations with income earned abroad, partnerships, holding companies, and closely held corporations.

1962 by advocating an increased investment tax credit, to be balanced against withholding on dividends and interest.[23] Although the final bill broadened the investment tax credit to cover previously excluded industries and all new capital investment, the withholding provisions for interest and dividends were dropped.[24] The 1962 bill, the first major revenue legislation in eight years, was insignificant in comparison with the 1964 legislation, however.[25] Legislation in 1964 lowered tax rates across the board. The 1964 Act began as structural tax reform, but settled for selective provisions benefitting special interests in addition to the general tax cuts.[26]

It was not until 1968-69 that Congress geared up for another run at "tax reform." The Tax Reform Act of 1969 was widesweeping, generally focusing on revenue-increasing provisions. By and large, the increased revenue came from the enactment of structural changes, including repeal of the investment tax credit, rather than from an increase in income tax rates.[27] The 1969 Act represented the first significant overhaul of the 1954 Code, but as often happens with tax reform, the final law was not as draconian as the version of the bill that initially passed the House Ways and Means Committee.[28]

The beginning of the 1970s was relatively peaceful with respect to tax legislation, but the pace quickened considerably by the end of the decade. The Tax Reduction Act of 1971 reinstated the investment tax credit, liberalized depreciation deductions, and created certain export incentives.[29] At the same time, it adjusted rates to provide tax relief for individuals.[30] Despite threats of extensive tax reform, no significant tax legis-

23. Withholding on interest and dividends was intended to increase the taxes collected from those sources of income. *Id.* at 156.

24. *See id.* at 156-57. The bill also included liberalized business deductions.

25. *See id.* at 158-59.

26. *See id.* at 163-65. The legislation eliminated few major tax reduction devices. New provisions included a moving expense deduction, income averaging, a minimum standard deduction, and a capital gains exclusion on the sale of homes by the elderly.

27. The structural changes included a minimum tax on preference income and increased taxes on mineral properties, banks, and financial institutions. The bill also tightened up perceived abuses of charitable exemptions for tax purposes. *Id.* at 167.

28. For example, the House Ways and Means Committee failed in its attempt to eliminate the tax exempt status of state and municipal bonds. *Id.* at 168-73.

29. *Id.* at 176.

30. *Id.* at 177-79.

lation materialized between 1972 and 1974, with the exception of changes in the tax laws governing pensions.[31]

The dam burst, however, with the enactment of the Tax Reduction Act of 1975 and the Tax Reform Act of 1976. Anticipating the massive 1976 legislation, the 1975 Act was a preliminary measure that tightened up on oil depletion allowances, increased the investment tax credit, and offered tax aid to profitless industries by extending the loss carryback provisions.[32] Then, in the Tax Reform Act of 1976, Congress enacted many of the provisions that it had considered previously during the relatively inactive tax years of 1972 to 1974. Although the legislation contained some revenue-gaining provisions, its thrust was to extend and create new benefits.[33] By all accounts, the 1976 legislation was long, complicated, and lacking in systematic reform of any kind. Perhaps recognizing these deficiencies, the 1976 Congress required a study of the problem of tax simplification.[34]

The pattern in 1977 and 1978 paralleled the 1975-76 sequence. A stopgap bill passed in 1977 presaged more substantial legislation to come. Aware of the incessant growth of federal income tax provisions, Congress entitled the legislation "The 1977 Tax Reduction and Simplification Act."[35] One of its major features was a new jobs tax credit with a complexity typical of the rest of the bill.[36] The Revenue Act of 1978 began with the usual tax reform rhetoric of simplification, equity, and stimulation of investment. By the time the bill was passed, however, any cohesion in the original proposal had been lost.[37]

The next important enactment was the Economic Recovery Tax Act of 1981, a major tax reduction bill. The principal features included lower tax rates across the board, inflation-in-

31. *Id.* at 179.

32. *Id.* at 186.

33. *See id.* at 197. One potentially major feature of the Tax Reform Act of 1976 was the repeal of the step-up in basis of assets at death, which would have interfered radically with intergenerational transfers. *Id.* at 195. Before the provision became effective, however, Congress repealed it in the Windfall Profits Tax Bill of 1980. *Id.* at 218.

34. *See* Tax Reform Act of 1976, Pub. L. No. 94-555, § 507, 90 Stat. 1520, 1569 (requiring the Joint Committee on Taxation to "make a full and complete study and investigation with respect to simplifying and indexing the tax laws of the United States"); *see also* 122 CONG. REC. 26, 131-32 (1976) (amendment by Sen. Hart proposing establishment of a "Commission on Tax Simplification and Modernization").

35. J. WITTE, *supra* note 3, at 199.

36. *See id.* at 203.

37. *Id.* at 213-15.

dexed tax rates, increased depreciation deductions, more generous transfers of tax benefits, larger research and development deductions, a building rehabilitation investment tax credit, and a deduction for a family's second earner.[38] Overall, the 1981 Act gave taxpayers the largest tax cut in American history.[39]

The dust had hardly settled from the 1981 changes when the Tax Equity and Fiscal Responsibility Act of 1982 eliminated part of the previous year's tax reduction and also tightened up on compliance.[40] In 1984, Congress again rearranged the tax furniture by enacting the Tax Reform Act. It froze some provisions from the 1981 legislation scheduled to reduce taxes and tightened up perceived loopholes in the corporate tax area and in the treatment of certain debt instruments.[41] The 1984 Act is notable, however, not so much for any new direction in tax policy, but for its reach into virtually all areas of taxation, as the 1300-page conference report suggests.[42]

Hard on the heels of the 1984 changes, the House in 1985 passed a voluminous tax reform bill.[43] In 1986, the Senate voted almost unanimously on a tax bill significantly different from the House bill.[44] Touted as the most comprehensive treatment of the federal income tax system since the 1954 codification, the Tax Reform Act of 1986 occupied center stage for both politicians and those taxpayers with the most to gain or lose as it proceeded to the House-Senate Conference Committee. In September 1986, the two congressional chambers passed the conference agreement, a bill that borrowed from both the Senate and House proposals and included some new provisions as well.[45] Finally, in October, 1986, President Reagan signed the Tax Reform Act of 1986, which modified the prior code to such an extent that it has been redesignated the "Internal Revenue

38. For a detailed discussion of the Act's history, see *id.* at 221-35; *see also* Feld, *Fairness in Rate Cuts in Individual Income Tax,* 68 CORNELL L. REV. 429 (1983) (discussing the Act's effect on individuals).

39. *Id.* at 221.

40. *See* Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324.

41. Tax Reform Act of 1984, Pub. L. No. 98-369, 1984 U.S. CODE CONG. & ADMIN. NEWS (98 Stat.) 494.

42. *See* H.R. CONF. REP. NO. 861, 98th Cong., 2d Sess. (1984), *reprinted in part in* 1984 U.S. CODE CONG. & ADMIN. NEWS 1445.

43. *See* H.R. 3838, 99th Cong., 1st Sess., 131 CONG. REC. H12826 (daily ed. Dec. 17, 1985).

44. *See infra* note 212 and accompanying text.

45. *See infra* note 214-15 and accompanying text.

Code of 1986."[46]

B. LEGISLATIVE TRENDS

This cursory historical review is not intended merely to suggest the ubiquity or inevitability of taxes. Rather, it illustrates the fact that tax change is practically as old as the tax code itself. In turn, it raises the questions of principal concern here: whether there has been an acceleration in the rate of tax change, and if so, why?

A recent study by John Witte tackles the first question by focusing on all "tax expenditures"[47] in effect between 1974 and 1982, regardless of when enacted.[48] The study found a relatively even distribution of new tax expenditures enacted between 1909 and 1982:[49]

	1909-19	1920-45	1946-69	1970-81	Total
Expenditure Provisions Originating in Period	25	18	24	22	89

Review of modifications of existing code provisions, however, revealed a different pattern. Of the eighty-eight tax expenditures studied,[50] twenty have never been modified once en-

46. Tax Reform Act of 1986, Pub. L. No. 99-514, § 2(a), 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085.

47. "The term 'tax expenditures' means those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability . . . ." Congressional Budget Act of 1974, Pub. L. No. 93-344, § 3(a)(3), 88 Stat. 297, 299 (codified at 2 U.S.C. § 622(3) (1982)). *See generally* B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 3.6 (1981) (discussing the definitional difficulties and other debatable aspects of the tax expenditure concept). The term corresponds generally to the popular notion of "tax breaks."

The breadth of tax legislation makes any inclusive study unwieldy and, at the same time, makes any casual empiricism suspect. It might be possible to count new code provisions or new words added to the code or pages of legislative history or any of a number of other proxies indicating growth in the tax laws. None of these methods, however, would prove entirely satisfactory.

48. J. WITTE, *supra* note 3, at 269-335.

49. The data are extracted from J. WITTE, *supra* note 3, at 316.

50. The discrepancy between the 88 tax expenditures cited here and the 89 provisions referred to in the text accompanying note 49 *supra*, results from the fact that Witte's study treats health and education deductions variously as either separate tax expenditures or as part of charitable deductions in general. J. WITTE, *supra* note 3, at 421 n.2.

acted.[51] Others have been modified almost annually.[52] Overall, the eighty-eight tax expenditures in existence during the 1974-82 period have been modified 318 times as follows:[53]

1909-19	1920-45	1946-69	1970-81
5	35	114	164

In other words, over half of all the modifications studied by Witte have occurred since 1970.[54]

The increasing rate of tax reform is further illustrated by the timing of modifications over the life of each expenditure.[55] Changes occur throughout the life of a provision, not just in the immediate postenactment period for fine tuning purposes. For the typical provision, over half of the changes occurred more than twenty years after its enactment.[56] Perhaps more re-

51. *Id.* at 312.

52. For example, the capital gains provisions have been modified 36 times since enactment in 1921. *Id.*

53. *See id.* at 315.

54. *Id.* at 314-15; *see infra* note 63. The percentage of changes occurring recently would be larger, of course, if Witte had chosen 1969 rather than 1970 as the point of demarcation, because the Tax Reform Act of 1969 would then be counted as a recent change. *Id.* at 314.

55. The following table has been extracted from J. WITTE, *supra* note 3, at 316.

FREQUENCY OF TAX CHANGES, 1909-81
BASED ON THE AGE OF THE PROVISION

	Year Provision Originated					
Age of Provision When Modified	1909-19	1920-45	1946-69	1970-81	Total	(%)
1-5	8	3	7	21	39	(12.3)
5-10	1	3	26	11	41	(12.9)
11-20	6	18	41	NA	65	(20.4)
21-30	5	16	30	NA	51	(16.0)
31-40	19	8	3	NA	30	(9.4)
41-50	14	24	NA	NA	38	(12.0)
+50	36	18	NA	NA	54	(17.0)
Total modifications	89	90	107	32	318	(100.0)
Modifications per year	.06	.11	.20	.39	.17	

Modifications per year is the "mean of the number of modifications for each provision divided by the number of years the provision has existed. Provisions are categorized by the year of origin. Thus, for example, the average number of modifications per year for provisions originating between 1909 and 1919 is 0.06." *Id.*

56. *See supra* note 55; J. WITTE, *supra* note 3, at 314. The table shows that

vealing, the rate of modification has increased in recent years. The modifications per year to a given tax expenditure provision increase steadily from the 1909-19 period to the 1970-81 period.[57] Moreover, the increase in annual modifications cannot be attributed solely to recently enacted provisions. Thus, for the forty-five[58] tax expenditures enacted prior to 1946, forty-two changes were made before 1946 and 133 changes in the same provisions since the war.[59]

A less comprehensive study by Harold Apolinsky supports Witte's finding of an accelerating rate of tax legislation.[60] The Tax Reform Act of 1969, the first major overhaul of the 1954 Code,[61] affected only 271 subsections of the Internal Revenue Code. In comparison, six major bills since 1976 have affected 5,815 Code subsections.[62]

Statute	Number of Code Subsections Affected
Tax Reform Act of 1976	1,849
Revenue Act of 1978	664
Economic Recovery Tax Act - 1981	483
Tax Equity and Fiscal Responsibility Act - 1982	530
1984 Deficit Reduction Act	2,245
1984 Retirement Equity Act	44
TOTAL	5,815

The Witte and Apolinsky data demonstrate that tax changes are occurring with growing frequency.

In addition, the data reveal some interesting characteristics of the modifications enacted by Congress. For example, although amendments to tax expenditures tend to increase benefits to taxpayers, that tendency is less pronounced than commonly believed.[63] Furthermore, expenditures denominated as

45.6 percent of the modifications of a typical provision occur in the first 20 years after enactment.

57. *See* last line of table *supra* note 55.

58. See *supra* note 50 for an explanation of the discrepancy between the 45 tax expenditures referred to here and the 43 referred to in the table at *supra* note 49.

59. J. WITTE, *supra* note 3, at 314.

60. *See* Apolinsky, *The Changes Just Cost Money*, Wash. Post, Apr. 6, 1986, at C8, col. 1.

61. *See supra* notes 27-28 and accompanying text.

62. *See* Apolinsky, *supra* note 60. Since 1981, legislation has affected 3,302 subsections of the Internal Revenue Code (IRC).

63. The following table characterizes modifications of tax provisions by

economic incentives, such as capital gains provisions,[64] undergo changes more frequently than do those classified as "need-based" or "tax equity."[65] Finally, the tax changes seem unrelated to government financing needs. Although Congress did implement tax changes to finance the country's wars during this century,[66] the most tumultuous period of tax change has been in the past decade, when no important new revenue requirements were evident. Part II seeks to explain this apparent anomaly.

II. THEORIES OF TAXATION

Tax change ("reform") has been an accelerating phenome-

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year enacted according to the effect on taxpayers. Taxpayers benefit if more taxpayers are covered by a favorable provision and/or if the provision becomes more favorable for existing taxpayers. Taxpayers are hurt if fewer taxpayers are covered by a favorable provision and/or the provision becomes less favorable for existing taxpayers. *See* J. WITTE, *supra* note 3, at 317-18. The following table summarizes Witte's data, *id.* at 315:

TAX EXPENDITURE MODIFICATIONS BY CATEGORY OF PROVISION, 1908-81

	Year of Modification					
Provision	1909-19	1920-45	1946-69	1970-81	Total	(%)
Benefits taxpayer	3	22	56	105	186	(58.5)
Neutral change	0	2	5	16	23	(7.2)
Hurts taxpayer	2	11	53	43	109	(34.3)
Total	5	35	114	164	318	(100.0)

Some specific examples also serve to demonstrate that tax expenditure modifications do not routinely or overwhelmingly benefit taxpayers. Of the thirty-six amendments to the capital gains provision, *see supra* note 52, only twenty represent increases in or expansion of the preference. *See id.* at 312. Similarly, Congress increased benefits related to oil, gas, and mineral rights twelve times, yet it also decreased the benefits twelve times and enacted neutral amendments twice. *Id.* A final example relates to the investment tax credit, enacted in 1962. Since 1962, it has been repealed twice, reenacted or increased fourteen times, and subjected to neutral changes twice. *Id.*

64. Other examples include oil, gas, and mineral expenditures and the investment tax credit. *See id.* at 318.

65. *Id.* Medical deductions are considered "need-based," and the earned income credit is an example of a "tax equity" provision. *See id.* at 272-88. The authors do not necessarily agree with Witte's classifications. Many (if not nearly all) of the so-called tax equity and need-based tax expenditures benefit special interests. For example, the provision authorizing deductions for state and local taxes is listed as a tax equity provision. *Id.* at 277. State and local politicians more likely see it as their special interest provision. *See* 132 CONG. REC. S8231-32 (daily ed. June 24, 1986) (statement of Sen. Dominici).

66. *See supra* notes 7 & 13-20 and accompanying text.

non, with a disproportionate number of modifications to the seventy-year-old income tax system occurring since 1970. To explain change, one must begin with an explanation of why taxes exist in the first place. A priori, changes in the underlying reasons for taxation should explain changes in taxes themselves.

A. PUBLIC FINANCE THEORY

The traditional explanation of taxation is part of the wider theory of "public finance" or "government finance,"[67] which treats taxes in one of two ways. Taxes may be merely the income statement complement of government spending. Taxes in this sense are a necessary evil, raised only to finance "necessary" government spending for public goods that private markets cannot provide,[68] including socially desired income redistribution.[69] Public finance theory treats other taxes as a

67. *See generally* J. DUE & A. FRIEDLANDER, GOVERNMENT FINANCE: ECONOMICS OF THE PUBLIC SECTOR (5th ed. 1973) (noting that societal needs are met either through private enterprise or through the centralized economy of the government); O. ECKSTEIN, PUBLIC FINANCE (2d ed. 1967) (defining public finance as the study of the revenue and expenditure activities of government); C. SHOUP, PUBLIC FINANCE (1969) (noting that the theory of public finance addresses government services, that taxation is a method by which the costs of the services are covered, and that other methods include borrowing, foreign aid, and the creation of new money).

68. In a capitalist economy such as that of the United States, which essentially relies on private market transactions, government provision of certain goods and services in principle still has a role. Private producers may not supply certain public goods, for example, even though purchasers would be willing to pay enough to cover the costs of production. The problem with private provision of public goods is that, by definition, the benefits of a public good cannot be restricted to those who pay for it.

The usual example of a public good is national defense. Everyone benefits collectively from the construction of an early warning missile system. There is no way to exclude any person from the umbrella of defense afforded by the missiles. Individuals, then, have an incentive to let others pay for the missile system but to refuse to pay themselves, because they enjoy the same level of protection regardless of their own contribution. Because all face the same incentives, no one actually will pay for the defense system unless "coerced" into doing so. Government taxation in this instance finances government goods and services that presumably all want, but that no one would pay for unless payment was mandatory.

69. Some people maintain that as a society we may prefer a different income distribution from that produced by market transactions. *See, e.g.*, Thurow, *The Income Distribution as a Pure Public Good*, 85 Q. J. ECON. 327 (1971) (analyzing income redistribution from a voluntary exchange theory). No one person acting alone can appreciably affect the distribution of income, but each would be willing to be "coerced" to transfer a portion of his wealth to the less wealthy, if others did so as well. Mandatory taxation then finances

means of correcting private externalities. In other words, the government levies some taxes to reduce the level of some private activities that impose costs on others.[70]

With specification of the appropriate role of taxation in providing public goods and reducing external costs, much of the traditional public finance literature is devoted to theories of the "optimal tax" to be levied.[71] This literature is essentially normative, however, seeking to prove which tax rates, structures, and incidences are best in any given situation. The real world of taxation rarely, if ever, conforms to the optimal tax models of public finance theorists. Theoretical models of what would be best do not even attempt to explain what is actually observed.[72]

Several problems are inherent in the traditional model. Most fundamental is the notion that taxation, as a necessary evil, only arises once a popular desire for certain government activities has arisen. Neither the Constitution nor any other legal standard, however, requires that taxes be tied to specified government actions.[73] As the size of the national debt attests, government spending and taxing have never been tightly linked, whatever the theoretical rationale for doing so.

The lack of congruence between particular taxes imposed and the supposed rationale for them also shows the sterility of the traditional model. For example, although liquor and tobacco taxes are justified as reducing externalities, Congress has never attempted to correlate the tax rates with the social costs

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the public good of wealth redistribution that all would favor but could not obtain without government action.

70. A typical example is air or water pollution created in manufacturing, which reduces the value of surrounding lands or rivers. If not forced to take account of the costs imposed on others, the manufacturer has an incentive to generate the externality. Taxes on the polluter are one way to force the manufacturer to "internalize," to take into account, the costs imposed on others. Taxes to correct externalities thus are akin to liability rules in nuisance actions. *See* Calabresi & Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral,* 85 HARV. L. REV. 1089, 1105-06 (1972).

71. *See, e.g.,* Slemrod, *Do We Know How Progressive the Income Tax System Should Be?,* 36 NAT'L TAX J. 361 (1983) (discussing optimal progressivity of the income tax).

72. Two leading public finance theorists have recently noted that "[t]he orthodox analysis provides [no] understanding of observed fiscal process." G. BRENNAN & J. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION xii (1980).

73. *Id.* at 8. For a recent summary of the large body of empirical work on the actual link between permanent government spending and taxing, see von Furstenberg, Green & Jeong, *Tax and Spend, or Spend and Tax,* 68 REV. ECON. & STAT. 179 (1986).

incurred as a result of society's use of such products.[74] Rather, because demands for these products are thought to be inelastic, the high taxes imposed may just reflect the high revenue-collection potential.[75] Further, many taxes simply cannot be explained as either financing public goods or mitigating externalities.[76] The traditional theory of public finance, then, provides little help in understanding why taxes change, as it gives little insight into why taxes actually exist in the first place.

B. THE POLITICAL ECONOMY OF TAX LEGISLATION

That the traditional optimal tax theory of public finance is a poor predictor of how and why government actually taxes is perhaps not surprising. Viewed more generally, taxation is simply one form of government regulation. As an entire literature in the past fifteen years has made clear, older theories of how government *should* regulate tell very little about how government actually *does* regulate.[77] In particular, it is increasingly accepted that government often does not regulate in any optimal, public interest fashion, but rather that it supplies regulation to particular interest groups that demand it.[78] This perspective, often referred to as the "economic theory of regulation,"[79] sees government action supplied in response to demands from well-organized groups that are willing to pay for it in votes, campaign contributions, and so forth. A growing body of empirical evidence shows that much regulation has favored some groups at the expense of others.[80] As a result, analysts in-

74. *See* J. DUE & A. FRIEDLANDER, *supra* note 67, at 384.

75. *Id.*

76. Consider, for example, excise taxes on telephone service or butter.

77. *See generally* Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. 335 (1974) (discussing the flaws of various theories of government regulation).

78. "Regulation is . . . an instrument of wealth transfer—the extent of which is determined in a political market—where interest groups demand regulation and politician-regulators supply it." Migué, *Controls Versus Subsidies in the Economic Theory of Regulation*, 20 J. LAW & ECON. 213, 214 (1977).

79. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. 3 (1971). For a discussion of the public interest and economic theories of regulation, see McChesney, *Regulation, Taxes and Political Extortion*, in THE REGULATORY REEDUCATION OF THE REAGANITES (R. Meiners & B. Yandle eds. 1987) (forthcoming).

80. For a good summary, see McCormick, *The Strategic Use of Regulation: A Review of the Literature*, in FEDERAL TRADE COMMISSION, LAW AND ECONOMICS CONFERENCE, THE POLITICAL ECONOMY OF REGULATION: PRIVATE INTERESTS IN THE REGULATORY PROCESS 13 (1984).

creasingly believe, the economic theory of regulation has supplanted public interest theories in explaining most aspects of politics.[81]

Until recently, however, taxation remained the exclusive preserve of the more traditional public finance literature and had not been analyzed rigorously within the economic model of government.[82] No reason exists, however, to believe that the political process of taxation would not operate like other regulatory processes. Because taxation has a direct impact on private wealth, one would expect private interests to work just as hard to procure favorable tax outcomes. As with other regulatory legislation, private interests predictably would obtain the tax legislation that they are willing to pay for.

1. Gains to Private Interests from Being Taxed

Although one might think that private interests would prefer and thus pay for no tax at all, that is not always true. A tax can be beneficial to some private producers if it strikes their competitors even harder. Consider the situation portrayed in Figure 1.

81. *See* Kalt & Zupan, *Capture and Ideology in the Economic Theory of Politics*, 74 AM. ECON. REV. 279, 279 (1984).

82. For one incorporation of taxation into the more general economic model of regulation, see McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101 (1987). For an economic model of taxation based on majoritarian, constitutional principles, see G. BRENNAN & J. BUCHANAN, *supra* note 72. Other papers have analyzed certain aspects of taxation from the perspective of political economy. *See, e.g.*, Anderson, *On the Unlikelihood of Sensible Tax Reform*, 4 AM. J. TAX POL. 81 (1985); Shughart, Durable Tax Reform (Feb. 1985) (unpublished manuscript on file at Minnesota Law Review).

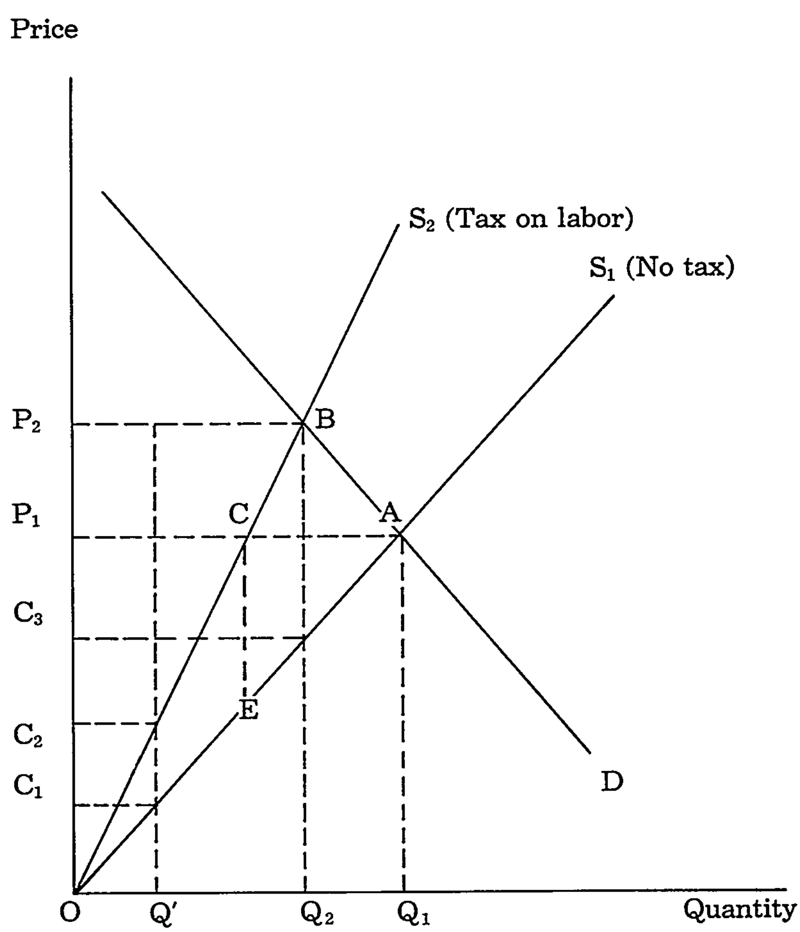

Figure 1

Industry demand (D) and supply (S_1) establish price P_1 in the absence of taxation. The supply curve is simply the summation of all firms' marginal cost curves. Thus, at price P_1, firms earn returns above cost, because the price is above the cost of producing any unit of the good in question, except the last unit produced. Unit Q′, for example, has a marginal cost of C_1 but sells for P_1. Total returns above cost for all units are measured by triangle OAP_1, an area economists call "producers' surplus."[83]

Suppose, however, that some firms are capital-intensive

83. *See, e.g.*, W. VICKREY, MICROSTATICS 263 (1964).

while others are relatively labor-intensive[84] and that the labor-intensive firms are the more marginal, "higher-cost" ones. If a tax is placed on labor, its effect is to increase the costs of labor-intensive firms more than those of their capital-intensive competitors. The industry supply curve shifts to S_2 as a result of the tax: the costs of all units produced increases, but those produced by labor-intensive firms rise more. The cost of producing unit Q, for example, rises only from C_1 to C_2, while the cost of Q_2 rises from C_3 to P_2.

The firm producing the lower-cost Q units actually gains from the tax, because the amount that costs rise due to the tax is less than the increase in the price ($C_2 - C_1 < P_2 - P_1$). The gain results because other firms have higher costs, which at the margin increase prices for all sellers. Total returns above cost *increase* because of the tax from OAP_1 to OBP_2.[85] As a result, private interests will benefit from a tax as long as one or more competitors bear a disproportionate share of the burden incurred.[86]

Indeed, examples of battles over taxes between and within industries exist in connection with recent tax legislation. For example, the Economic Recovery Tax Act of 1981 significantly increased the rate of depreciation for capital.[87] Increased depreciation deductions translate into lower taxes on capital, which in effect means a higher relative cost of labor. Not surprisingly, the lobbying efforts pitted capital-intensive industries against labor-intensive industries and organized labor.[88] Labor

84. In a labor-intensive firm, the ratio of labor costs to total costs is higher than such ratio for all industries on average. Examples include the textile, furniture, and services industries. *See generally* Kemp, *Federal Tax Law: The Need for Radical Reform*, 12 J. LEGIS. 1 (1985) (discussing tax system inequities with respect to labor intensive industries).

85. In other words, the gain in producers' surplus (P_1CBP_2) is greater than the producers' surplus lost (OAC).

86. The tax is like a minimum wage increase which penalizes smaller, labor-intensive firms and actually helps their larger, capital-intensive competitors. Even though all firms must pay the higher minimum wage, which is effectively a tax on labor, some firms must pay more than others, thus benefiting their competitors. *See, e.g.*, Kaun, *Minimum Wages, Factor Substitution and the Marginal Producer*, 79 Q. J. ECON. 478 (1965). For a similar discussion of how higher union wage rates hurt marginal, labor-intensive firms, see Williamson, *Wage Rates as a Barrier to Entry: The Pennington Case in Perspective*, 82 Q. J. ECON. 85 (1968).

87. The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 201, 95 Stat. 172, 203-19.

88. Shanahan, *New Diverse Coalition Works to Pass Tax Bill*, 44 CONG. Q. WEEKLY REP. 1147, 1148 (1986); *Congress Enacts President Reagan's Tax Plan*, 1981 CONG. Q. ALMANAC 91, 92-93.

opposed a tax cut benefiting capital, just as capital would favor a tax penalizing labor.

Similar internecine rivalries arose in connection with the Senate Finance Committee version of the 1986 Tax Reform Act. For example, the Committee's bill contained several provisions that would adversely affect the real estate industry in general, including longer depreciation periods and a passive income limitation that would restrict tax advantages for limited partners not actively managing their investments.[89] Although many segments of the real estate industry opposed the provisions, many developers not dependent on income from non-real estate sources or on capital contributions from investors outside the real estate business did not oppose the bill.[90] Similarly, the National Association of Real Estate Investment Trusts (REITs) supported the tax reform[91] because the Senate bill sharply curtailed the ability of partnerships to pass through losses to partners,[92] formerly an advantage of the partnership form over the REIT.[93]

Thus taxes, like environmental,[94] safety,[95] and other regulatory measures,[96] can actually benefit firms that have to bear the costs, if their competitors bear an even greater cost. Nevertheless, special interest groups apparently fight more frequently for legislation helpful to them specifically rather than for legislation that is harmful to competitors. Such behavior is

89. Starobin, *Real Estate Lobby Seeks Tax Bill Changes But Cannot Agree How to Pay for Them,* 44 CONG. Q. WEEKLY REP. 1152, 1152 (1986).

90. *Id.* at 1153.

91. *See* Novack, *What Hurts My Enemy Helps Me,* FORBES MAG. Aug. 11, 1986, at 73.

92. *See* H.R. CONF. REP. NO. 841, 99th Cong., 2d Sess. at II-137 to -140 (1986); *see also* Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2058 (codified at I.R.C. § 469 (West Supp. 1987)).

93. "What delights REIT proponents . . . is not that REITs will win a lot of special privileges. Rather, they are happy because competing forms of real estate ownership—chiefly partnerships and corporations—will likely lose their privileges. What's bad for my enemy is good for me." Novack, *supra* note 91, at 73.

94. *See, e.g.,* Maloney & McCormick, *A Positive Theory of Environmental Quality Regulation,* 25 J. LAW & ECON. 99 (1982); Pashigian, *The Effect of Environmental Regulation on Optimal Plant Size and Factor Shares,* 27 J. LAW & ECON. 1 (1984).

95. *See, e.g.,* Bartel & Thomas, *Direct and Indirect Effects of Regulation: A New Look at OSHA's Impact,* 28 J. LAW & ECON. 1 (1985); Marvel, *Factory Regulation: A Reinterpretation of Early English Experience,* 20 J. LAW & ECON. 379 (1977).

96. *See* McCormick, *supra* note 80, and works cited therein at 27-32.

not surprising, as legislation harmful to competitors may benefit free riders in addition to the special interest that would pay for the legislation. Unless the special interest can capture all of the gains from such legislation, it may be more efficient to promote specific legislation designed to help the special interest alone.[97]

2. Gains to Private Interests from Not Being Taxed

Although taxes that affect sellers in a particular industry have the potential actually to benefit some firms at the expense of their competitors, many taxes seem to benefit no identifiable group. Consider Figure 2, in which an excise tax of OF is levied on all producers equally.

97. *See* Anderson, *supra* note 82, at 94.

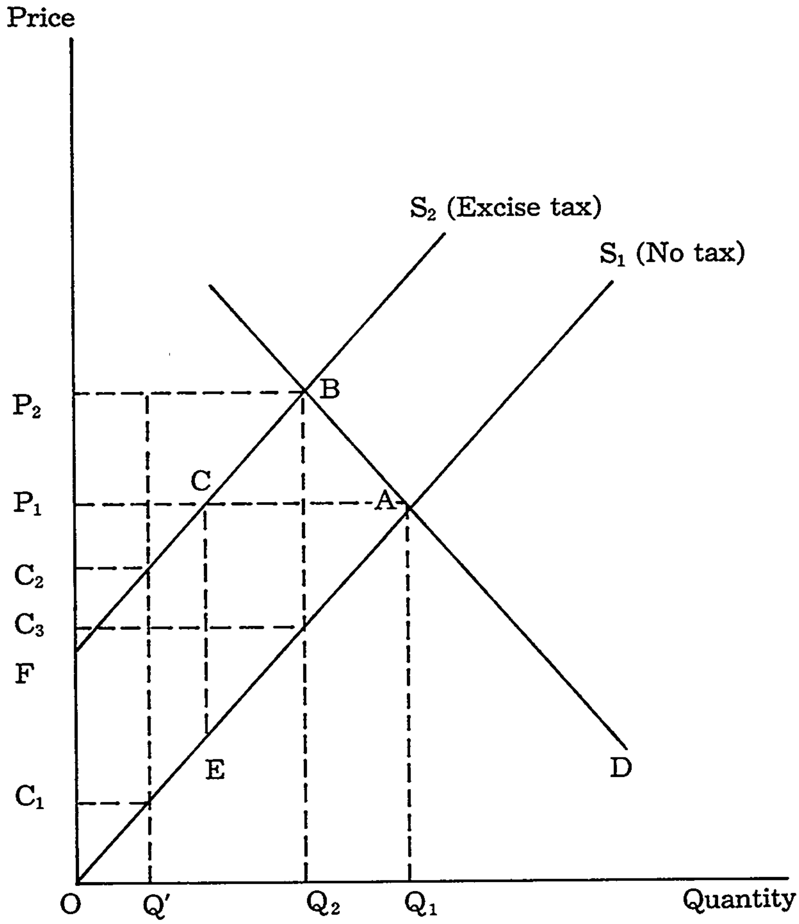

Figure 2

The cost increase is the same for all producers: for example, $C_2 - C_1$, representing the cost increase for the producer of Q, equals $P_2 - C_3$, for the producer of Q_2. All producers are in a worse position because of the tax, as the amount of producers' surplus shrinks from triangle OAP_1 to the smaller area FBP_2.[98] The price increase for all firms, $P_2 - P_1$, is less than the cost increase, OF, faced by all. As compared to the labor tax levy in Figure 1 above,[99] the tax here has no benefit for anyone in the

98. That is, the area of producers' surplus lost (OACF) is greater than the area gained (P_1CBP_2).

99. *See supra* notes 83-88 and accompanying text.

industry. All firms suffer, as prices rise less than costs.

The existence of this sort of excise harmful to all seems inexplicable under an economic theory of taxation, which hypothesizes that Congress enacts legislation to confer benefits on an interest group willing to pay them. Thus far, however, the analysis has failed to account for the interests of one important group: politicians themselves. Like any other professional, a politician has a product to sell—legislation. If that legislation benefits some group, a politician will expect to be compensated like any other provider of a beneficial good or service. That is to say, part of the private gain from taxes must be shared with the politicians who legislate them.

A legislator has the power not just to favor certain groups, but to harm them. Even if a special interest is not willing to pay for tax legislation that injures competitors, it may be willing to pay to forestall legislation harmful to itself.[100] The threatened excise in Figure 2, therefore, can be politically valuable precisely because private parties may offer to compensate legislators rather than suffer the net losses (OAP_1 - FBP_2) that would result from the tax.[101]

Legislators can and do propose legislation, sometimes referred to as "milker bills" or "juice bills," intended to squeeze payments from the potentially affected parties, rather than actually to be enacted into law.[102] The "milker" concept is exemplified by the reaction of at least one congressman to the bill that eventually gave rise to the 1986 Tax Reform Act. When the bill was on the verge of defeat on the House floor in late

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100. For further discussion on this point, see McChesney, *supra* note 82.

101. Of course, a politician's threat has to be credible. This problem and the ways that politicians can make credible their threats to impose taxes are discussed in McChesney, *supra* note 82.

102. As one commentator notes:

> Early on in my association with the California legislature, I came across the concept of "milker bills"—proposed legislation which had nothing to do with milk to drink and much to do with money, the "mother's milk of politics" . . . .
>
> . . . .
>
> Representative Sam, in need of campaign contributions, has a bill introduced which excites some constituency to urge Sam to work hard for its defeat (easily achieved), pouring funds into his campaign coffers and "forever" endearing Sam to his constituency for his effectiveness . . . .

Stubblebine, On the Political Economy of Tax Reform: Three Papers at the '85 WEA Meetings, 1-2 (July, 1985) (unpublished manuscript prepared for the 1985 meetings of the Western Economic Ass'n) (on file at Minnesota Law Review). For a discussion of politicians' use of "juice bills" in California, see Doerner, *California's Political Gold Rush*, TIME, Feb. 3, 1986, at 24.

1985, the legislator suggested to a colleague that he not vote to kill the bill yet. A better strategy, he suggested, was to keep the bill in "limbo for a few more months. 'Why kill the goose that laid the golden egg?' he asked."[103]

Given Congress's ability to exact payments simply by threatening harmful tax legislation, the fact that Congress actually does legislate might seem incongruous. As discussed above,[104] some tax legislation may be bought to harm competitors. Moreover, Congress may impose taxes harmful to everyone as part of an auction strategy by which it "opens bidding" with special interests to reduce costs specific to them.[105] Broad-based tax increases commonly precede or accompany specific tax relief measures for specific special interests.[106] Also, Congress may impose harmful tax legislation, even when no producers' surplus is extracted, to prove that it is not bluffing. Unless it proves from time to time that it is not bluffing, Congress would encounter difficulty in extracting compensation for threatened legislation.[107]

3. Politicians' Extraction of the Gains

The political process of using the specter of taxation to milk private groups for contributions hardly corresponds to the legislative process as taught in eighth-grade civics classes. In the civics-class version, tax bills typically originate in the House Ways and Means Committee,[108] proceed through formal hear-

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103. *See PAC Gifts to Tax-Writers Double,* 44 CONG. Q. WEEKLY REP. 297, 297 (1986).

104. *See supra* notes 83-96 and accompanying text.

105. *See* McChesney, *supra* note 82.

106. See, for example, the discussion of the 1986 tax reform efforts *infra* notes 217-29 and accompanying text.

107. The *Wall Street Journal* recently pointed out that strong special interests including the oil and gas drillers, real estate, timber, insurance, and military supplier PACs "are getting skunked" by the House version of the current tax reform effort. Jackson, *Ways and Means Measure Puts Biggest Tax Bites on Some of the Most Prolific Campaign Donors,* Wall St. J., Dec. 11, 1985, at 64, col. 1. Perhaps Congress was attempting to make good the threat of adverse legislation, or perhaps it was merely engaging in an auction strategy. Moreover, viewing "harmful" legislation in isolation can be misleading. What appears to be a harmful provision may actually be tame as compared to earlier versions.

108. The Constitution provides that "all Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments . . . ." U.S. CONST. art. 1, § 7; *see generally* Gallagher, *The Tax Legislative Process,* 3 REV. TAX. INDIVID. 203 (1979) (discussing the procedures by which Congress handles tax legislation). As a practical matter, the Senate's power to "propose or concur with Amendments" enables it in fact

ings[109] and committee and staff work,[110] and are reported to the full House,[111] which votes[112] and sends the bill to the Senate. The Senate process is similar to that of the House.[113] Once each chamber agrees on its own version of the bill, any differences are resolved in conference.[114] The compromise bill is

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to originate major portions of the tax measures that Congress actually passes. *Id.* at 207-08. Note that the Tax Reform Act of 1986 was initiated by a Treasury proposal. OFFICE OF THE SECRETARY, DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH, THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT (Nov. 1984). For the majority of bills that begin in the House, the Committee on Ways and Means has primary jurisdiction.

109. Typically, the tax legislative process begins with hearings held by the Ways and Means Committee, at which witnesses appear to summarize written arguments provided to the Committee in advance. Gallagher, *supra* note 108, at 204. If the legislation originated with the executive branch, administration representatives generally testify first. *Id.* at 205.

110. Even before the commencement of the hearings, the Staff of the Joint Committee on Taxation prepares a pamphlet describing the present law and the proposal for which hearings are scheduled. The Joint Committee on Taxation, established in 1926, consists of the five ranking members of the House Ways and Means and Senate Finance Committees. The Joint Committee has responsibility for the overall supervision of the operation, administration, and simplification of the federal tax laws. I.R.C. §§ 8021-8023 (1982). The functions are generally carried out by its staff of attorneys, accountants, economists, and statisticians. The nonpartisan Joint Committee plays an important role behind the scenes in shaping tax legislation. For example, revenue estimates produced by the Joint Committee along with the Treasury Department form a basis for shaping tax reform bills that will achieve Congress's revenue goals. Swardson, *Joint Committee on Taxes: Power Behind the Scenes*, Wash. Post, Oct. 27, 1985, § D, at 1, col. 1.

111. Following the conclusion of the hearings, Ways and Means "marks up" the proposed legislation generally rather than dealing with details of the actual legislation. When the Committee finishes its work, House Legislative Counsel along with staff members of the Joint Committee, Ways and Means, and Treasury translate the concepts into bill form. *See* Gallagher, *supra* note 108, at 206.

112. After the bill is reported by Ways and Means, the Committee decides the rule under which the full House will consider the bill. Under a "closed" rule, only the Committee may offer amendments. Under a "modified closed" rule, specified amendments can be offered. Once the rule is decided, the bill is debated on the House floor, where it can be recommitted to committee to enact specified changes, approved, or voted down. If approved, the bill passes to the Senate Committee on Finance. *Id.* at 206-07.

113. The work in the Senate begins with the Committee on Finance. Finance may either work from the House-approved bill or prepare its own. When Finance reports its bill, the entire Senate considers the effort. Generally, because of its smaller size, the Senate, unlike the House, allows both unlimited debate and amendment. *Id.* at 207-08.

114. Once the Senate has approved the bill, it is returned to the House for consideration. Although the House might approve the Senate changes outright, more typically a Committee of Conference of the House and Senate attempts to reconcile the differences between the House and Senate versions in

then approved by both chambers and sent to the President for his signature.[115]

The eighth-grade civics outline of tax legislation ignores a key part of the process—lobbying by special interests or through their agents. The "lobbyist" is an agent of some group or individual potentially affected by tax legislation. The relationship between special interests, acting through lobbyists, and legislators is central to understanding tax legislation. Lobbying occurs at all phases of the legislative process. For example, as Treasury begins to draft a bill, lobbyists participate by providing information.[116]

Although no reliable evidence is available to determine whether lobbyists or their principals provide pecuniary inducements for favorable legislation at the initial drafting stage, such inducements do play a major role as a tax bill moves through Congress. In 1985, for instance, nearly 8,000 lobbyists paid $49 million to persuade Congress,[117] averaging more than $91,000 per Congressional member. The lobbyists' payments exceeded by over fifty percent the $32.66 million that United States taxpayers paid as salaries to the 535 senators and representatives.[118] The payments take many forms, including campaign contributions, speech and personal appearance honoraria, and in-kind benefits.

a. *Campaign contributions*

Much of the lobbying focuses on the tax-writing committees. In 1985, political action committees (PACs) gave Ways and Means and Finance Committee members more than two times as much in compaign contributions as they did in 1983, a comparable non-election year period.[119] According to a Common Cause study based on reports filed with the Federal Election Commission, the fifty-six members of the two principal tax-writing committees raised $6.7 million from PACs in 1985 compared with $2.7 million for 1983.[120] Total campaign receipts by

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the Conference Report. Once the Conference Committee has done its work, the Conference Report is submitted to the House and Senate for approval. *Id.* at 208-09.

115. *Id.*

116. T. REESE, THE POLITICS OF TAXATION 42-44 (1980).

117. *Lobbyists' Price to Persuade Congress Hits $49 Million in '85,* Atlanta J., June 5, 1986, at 8, col. 1.

118. *Id.*

119. *"Gimme a Break,"* COMMON CAUSE NEWS, Feb. 11, 1986, at 1.

120. *Id.* at 1, 6.

the fifty-six committee members were $19.8 million—nearly double the $9.9 million raised in 1983.[121] Another study found that the average PAC contribution to Ways and Means members was thirty-one percent higher than the average received by all House members.[122] Ways and Means and Finance Committee members, comprising only 10.5 percent of the Congress, collected 23.5 percent of the fifteen million dollars given by PACs to all members of Congress during the first six months of 1985.[123] As the data suggest, the period during which tax reform is formulated can be particularly profitable for members of the tax-writing committees.[124]

Not surprisingly, the most influential members of the tax-writing committees garner the greatest contributions. Finance Committee Chairman Packwood (or should that be PACwood?) led Finance Committee members in almost all categories of financial activity for 1985—PAC receipts ($965,517), total receipts ($5,137,569), expenditures ($1,877,125), and year-end cash on hand ($3,545,970).[125] He also received $34,750 in honoraria during 1985.[126] Senator Dole was close behind, with direct PAC receipts of $595,750 and another $417,976 for his own PAC, Campaign America.[127] The campaign contributions, however, were widespread among all committee members.[128] Further, the 1985 figures do not reflect 1986 contributions made while the Finance Committee was considering the tax bill.

Similar patterns emerge on the House Ways and Means Committee, although the payments to Chairman Rostenkowski were slightly more subtle. Directly, he showed only $5,500 in outside PAC contributions. His own PAC, the Chicago Campaign Committee, however, raised $378,321 in 1985 and reported year-end cash on hand of $410,544.[129] Overall, fourteen of the thirty-six Ways and Means Committee members collected more

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121. *Id.*

122. *See* Pressman, *PAC Money, Honoraria Flow to Tax Writers*, 43 CONG. Q. WEEKLY REP. 1806, 1806 (1985) (citing a study by Common Cause). For PAC contributions to tax-writing committee members in 1986, see Hanlon, *PACs Pad Taxwriters' Campaign Accounts*, 33 TAX NOTES 529 (1986).

123. Pressman, *supra* note 122, at 1806.

124. "It is clear," concludes Pressman, "that a seat on a tax committee gives a legislator a fund-raising advantage over members of other congressional panels." *Id.*

125. *See "Gimme a Break," supra* note 119, at 2, app. I, at 2.

126. Hook, *Leaders, Finance Members Top Honoraria List*, 44 CONG. Q. WEEKLY REP. 1169, 1170 (1986).

127. *See "Gimme a Break," supra* note 119, at 3.

128. *See id., passim.*

129. *Id.* at 5, app. II, at 2.

than $100,000 from PACs during 1985.[130] Not all Ways and Means or Finance Committee members accept PAC money or honoraria. One who does not, Andrew Jacobs, commented that "[t]he only reason it isn't considered bribery is that Congress gets to define bribery."[131]

The value of campaign contributions to politicians is often misunderstood and underestimated. Even when a legislator faces no serious opposition in an upcoming election, political appetites for contributions remain voracious.[132] As Senator Russell Long succinctly told a lobbyist, "a U.S. Senator is primarily interested in two things—one, to be elected, and the other, to be reelected."[133] Even if the opposition faced by an incumbent is unimpressive, there is no such thing as too much money.

Perhaps the value of campaign contributions is underestimated because federal law limits the amount that can be given. Even under the stricter campaign statutes and regulations enacted during the 1970s,[134] however, limitations can be overcome. For example, PAC contributions have been limited to $5,000 per candidate per election for a congressional candi-

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130. *Id.* at 5-6.

131. Maranis, *PAC Heaven: Commerce Committee Members Roll Up Corporate Contributions,* Wash. Post, Aug. 21, 1983, § A, at 1, col. 2.

132. Consider, for example, the following:

> "Representative Dan Rostenkowski, of Illinois, raised $519,000 for the 1982 campaign, although he ran nearly unopposed, and raised another $168,000 in 1983. Rostenkowski is the chairman of the tax-writing Ways and Means Committee, whose members, along with those of the parallel Senate Finance Committee, have the easiest time obtaining donations, since they are in the best position to do specific money favors for specific industries."

Easterbrook, *What's Wrong with Congress?,* ATLANTIC MONTHLY, Dec. 1984, at 57, 71.

133. Fessler, *Russell Long: Tax Master and Senate Mentor,* 44 CONG. Q. WEEKLY REP. 797, 798 (1986).

134. During the 1970s Congress passed a succession of measures, known collectively as the Federal Election Campaign Act (FECA), closely regulating the activities of candidates, parties, private organizations, and individuals in raising and spending campaign money. *See* Presidential Election Campaign Fund Act, Pub. L. 92-178, 85 Stat. 562 (1971); Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1972); Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974); Federal Election Campaign Act Amendments of 1976, Pub. L. No. 94-283, 90 Stat. 475 (1976); Federal Election Campaign Act Amendments of 1979, Pub. L. No. 96-187, 93 Stat. 1339 (1979). FECA is codified at 2 U.S.C. §§ 431-455 (1982) and 26 U.S.C. §§ 9001-9013 (1982). *See also* Briffault, *The Federal Election Campaign Act and the 1980 Election* (Book Review), 84 COLUM. L. REV. 2083, 2084 (1984) ("while the 1970s reforms sought to alter the nature of political fund-raising and spending, in the 1980 campaign private wealth and special interest expenditures resumed their pivotal roles").

date,[135] but the limit is easily circumvented. Alignpac, a PAC formed by insurance sellers, avoided the limit by having its members make checks payable directly to Senator Packwood in an amount up to $1,000.[136] The PAC leaders periodically bundled up the contributions and delivered them to Packwood's campaign headquarters.[137] In this way, Senator Packwood received more than $168,000 in 1985 from a group ostensibly limited to a $5,000 contribution.[138] Multiple PACs with the same purpose can also avoid the $5,000 limitation. Consequently, insurance industry PACs now number about one hundred.[139] Finally, although there are limits on PAC contributions to candidates, federal election law does not limit independent expenditures by a PAC made without consultation with, or the cooperation of, any candidate or campaign.[140] For example, the Realtors' PAC spent almost $200,000 during the 1981-82 period to help candidates who supported pro-realtor legislation.[141]

PAC contributions must also be used for campaign rather than personal purposes. The distinction, however, is fuzzy. Politicians are always campaigning, or at least claiming to be. They have successfully justified as campaign rather than personal expenditures things like country club dues, Kentucky Derby tickets, a shotgun, leasing a Cadillac, lawyer's fees to defend a drunk driving suit, travel and entertainment expenses, New York Giant football tickets, liquor, insurance for works of art, bronze figurines for investment, golf clubs, trips abroad, and tax sheltered investments.[142] Additionally, many present legislators may create a de facto retirement fund, by keeping

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135. 2 U.S.C. § 441a(a)(2)(A) (1982). *See also* L. SABATO, PAC POWER—INSIDE THE WORLD OF POLITICAL ACTION COMMITTEES 9 (1984).

136. Jackson, *Insurance Industry Boosts Political Contributions as Congress Takes Up Cherished Tax Preferences,* Wall St. J., Oct. 10, 1985, at 64, col. 1.

137. Federal election law requires identification of the middleman in these transactions, but Senator Packwood's midyear report failed to mention Alignpac until it was called to his attention by the Wall Street Journal. *Id.* Similarly, limitations on individual gifts are easily circumvented. In raising money for this successful Senate campaign in 1986, Terry Sanford of North Carolina sent donors a guide showing how a couple, supposedly limited to a donation of $1,000 each to his campaign, could actually contribute a total of $44,000. Jackson, *Senate Hopeful Mails Donors a Guide on How to Skirt Limits on Contributions,* Wall St. J., Oct. 9, 1986, at 69, col. 1.

138. Jackson, *supra* note 136.

139. *Id.*

140. *See* L. SABATO, *supra* note 135, at 96-107.

141. *Id.* at 97.

142. Jackson, *Congressmen Charge All Kinds of Things to Campaign Chests,* Wall St. J., Dec. 3, 1985, at 1, col. 4.

unspent campaign contributions for their personal use after leaving Congress. Senators and representatives thus have been able to use money supposedly contributed to finance campaigns to create their own "individual retirement accounts." Although the law has now changed to outlaw these political IRAs, Congress exempted all members in office as of January 8, 1980 from the statute.[143] Thus, Packwood, Rostenkowski, Dole, and the other senior legislators responsible for the 1986 Act eventually can take their campaign war chests with them into retirement.

b. *Speaking and appearance honoraria*

Campaign contributions are not the only way to get money to politicians personally. Potential beneficiaries of legislation have increasingly paid legislators directly through "honoraria"—personal appearance and speaking fees.[144] Many senators earn more from speaking fees than from their salaries.[145] Significantly, in 1984, tax panel members received more than one million dollars in honoraria, or approximately twenty percent of the total $5.2 million paid to congressional members.[146] In 1985, Senators earned more than $2.4 million in honoraria.[147] Of that amount, the twenty members of the Finance Committee earned more than $660,000, or more than twenty-eight percent of the total.[148] The single largest recipient was Finance Committee member Robert Dole, who received $127,993.[149] Of the thirteen senators receiving honoraria totaling $40,000 or more, six were Finance Committee members.[150] For the House of Representatives, twenty of the thirty-nine members who earned $25,000 or more in honoraria served on the Ways and

143. 2 U.S.C. § 439a (1982).

144. Jackson, *Interest Groups Pay Millions in Appearance Fees to Get Legislators to Listen as Well as to Speak*, Wall St. J., June 4, 1985, at 62, col. 1; Jackson, *Lawmakers Got Record Fees in '83*, Wall St. J., May 25, 1984, at 58, col. 1.

145. Easterbrook, *supra* note 132, at 72, reports that eleven senators were paid more in fees than in salary in 1983. "[A]nd *paid* is the proper word: while congressmen use the word *honoraria* to make their appearances sound like some lofty philanthropic activity, anyone else who makes a speech in return for a fee is referred to as paid." *Id.*

146. Pressman, *supra* note 122, at 1806.

147. Hook, *supra* note 126.

148. *Id.* at 1170.

149. *Id.*

150. *Id.* See *infra* notes 153-55 and accompanying text for a discussion of the limits on retaining honoraria.

Means Committee.[151] The recipient of the greatest amount in the House was Representative Rostenkowski, Chairman of the Ways and Means Committee, who received $137,500.[152]

Disclosure requirements and limits on how much legislators can take annually in outside fees are similarly ineffective. By law, members of Congress are allowed to keep honoraria not exceeding thirty percent of annual salary.[153] On reaching the limit, however, a politician can make a well-publicized donation of the fees to charity.[154] Disclosure requirements and fee limits also do not apply to politicians' spouses, who often pick up fees of their own from lobbying organizations.[155]

c. *In-kind benefits*

PAC contributions and honoraria are but two of the methods used to bestow favors on those in a position to affect special interests financially. Many donors combine their pecuniary contributions with lavish in-kind benefits, as the movie industry has done.[156] Senator Pete Wilson of California received $50,000 from film industry PACs in 1985 and the first part of 1986; movie executives have donated thousands of dollars to Representative Rostenkowski's PAC.[157] In addition to the financial emoluments comes much free entertainment for legislators from the Washington office of the Motion Picture Association (MPA).[158] One executive of the MPA notes that entertainment and help in fund-raisers is something the MPA

151. Hook, *Ways and Means Members Top Honoraria List*, 44 CONG. Q. WEEKLY REP. 1239 (1986). Eleven of the others either were committee chairpersons or held top party leadership posts. *Id.*

152. *Id.*

153. In 1985, the Senate raised the ceiling to 40 percent of salary. The House followed suit in April of 1986, but reversed its action the next day. Hook, *supra* note 126, at 1169.

154. For data on donations made by Senators in 1985, see *id.* at 1170. The same source reports "[o]f the $2.4 million paid to Senators in 1985 . . . $723,038 was donated for charity, leaving about $1.7 million in Senators' own pockets." *Id.* at 1169.

155. Shafer, *Pay My Wife—Please!*, Wall St. J., May 24, 1985, at 1, col. 5.

156. *See* Jackson, *Congress, Wined and Dined by Jack Valenti, Writes a Rule Giving Hollywood a Tax Break*, Wall St. J., June 17, 1986, at 64, col. 1.

157. *Id.*

158. Recently, for example, one "senior Democratic member of the Ways and Means Committee, California Representative Pete Stark, treated about 50 of his friends to a private screening of an Alan Arkin film in the Motion Picture Association's 70-seat theater," with food and drinks provided by the MPA. *Id.*

does "[f]or the people who have been good to us."[159] The object of the MPA's recent lobbying has been retention of Hollywood's investment tax credit, which was finally inserted in the Senate bill by Senator Heinz of the Finance Committee, who said that he did so as a favor to Senator Wilson.[160]

In-kind donations are also important in swaying nonelected participants in the tax process, who are prohibited from accepting contributions or making paid speeches. For example, during consideration of the 1986 Tax Reform Act by the Ways and Means Committee, the Equitable Life Assurance Society flew a dozen congressional aides along with spouses or guests to New York, put them up at the Plaza Hotel, and entertained them at the U.S. Open tennis tournament, restaurants, and a Broadway show.[161] Nothing suggests that this is an isolated instance. Staffers do the actual drafting of tax legislation and often have the ear of members of the tax-writing committees, making it valuable for private interests to attract their attention.

4. Evidence of Contracting for Tax Legislation

That lobbyists play some role in the legislative process is easier to demonstrate than the nature of their role. Perhaps lobbyists are essentially information providers, arming busy legislators with the facts they need. The PAC funds and other inducements that lobbyists provide[162] could just be devices to direct legislators' attention to lobbyists' information. On the other hand, perhaps lobbyists are in the business of buying or forestalling legislation with PAC funds or other inducements.[163] There can be no conclusive proof one way or the other. What is evident, however, is that the cash keeps flow-

159. *Id.* "We try to reward people.... We will get a house, arrange for the caterer, arrange for the printing of invitations." *Id.*

160. *Id.* The 1986 Tax Reform Act provides a special "transition rule" for certain films, which under some circumstances allows film makers to take a credit for a percentage of production costs incurred after the general effective date of the investment credit repeal. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 211(e)(2), 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085.

161. *Special Interests Try to Influence the Tax Code,* Atlanta Const., Oct. 13, 1985, at M8, col. 1.

162. *See supra* note 117-61 and accompanying text.

163. As stated by Representative Fortney Stark, a member of Ways and Means, "America needs a tax bill each year (to give) a little help to your friends." Birnbaum, *House Committee Seeks Big Support for Tax Bill Through Myriad Concessions to Small Interests,* Wall St. J., Nov. 21, 1985, at 64, col. 1.

ing.[164] The availability of compensation suggests that legislators would not give away favors, but would require those benefiting from tax legislation to pay for the benefits conferred.

Abundant anecdotal evidence exists to show that legislation is bought and sold.[165] Examples of payments from special interest groups to retain favorable tax treatment during the most recent tax reform efforts are ubiquitous.[166] The Senate bill, for example, was loaded with special interest breaks with nicknames like "the Marriott amendment"[167] identifying the beneficiaries.[168] Likewise, on the House side, provisions like the "Gallo amendment" were written into the Ways and Means Committee bill, to the enrichment of committee members.[169]

164. For statistics on increased PAC contributions, see L. SABATO, *supra* note 135, at 10-24.

165. For episodes in addition to those recounted here, see Jackson, *Lawmakers Got Record Fees in '83,* Wall St. J., May 25, 1984, at 58, col. 1.

166. *See, e.g.,* Jackson, *Tax-Revision Proposals Bring Big Contributions from PACs to Congressional Campaign Coffers,* Wall St. J., Aug. 9, 1985, at 36, col. 1. Jackson writes:

> [T]he money is pouring in from such special-interest groups as insurance companies that want to preserve tax-free appreciation of life insurance policy earnings, from horse breeders who want to keep rapid depreciation of thoroughbreds, from drug companies seeking to keep a tax haven in Puerto Rico, and from military contractors seeking to retain favorable tax treatment of earnings from multiyear contracts.

Id.

167. The Marriott amendment carves out an exception to a proposed provision that would limit business meal and business entertainment deductions to eighty percent of the actual expense. The restriction is intended to separate the consumption element of such expenses (nondeductible) from the business component (deductible). The eighty percent limitation is one of the few provisions that appeared in both the House and Senate versions of the 1986 tax bill. A coalition of hotels and others heavily dependent on convention business convinced the Finance Committee to except business meals provided as an integral part of certain convention programs at least for 1987 and 1988. Murray, *Lobbyists and Chums from College Leave Imprint on Tax Bill,* Wall St. J., May 16, 1986, at 1, col. 4. The exception has been retained in the 1986 Act. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 142(b), 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 274(n)(2), (3) (West Supp. 1987)). To qualify for the "Marriott exception," a convention must include a speaker whenever food and beverages are included in the program. *Id.* (codified at I.R.C. § 274(n)(3)(D) (West Supp. 1987)). Politicians, thereby, have raised the demand for their own services as outside speakers.

168. Murray, *supra* note 167, at 1, col. 4. According to a former Treasury Department tax specialist, such breaks do not necessarily come free. He noted that "[i]t helps if you've been a big supporter of [a] senator. . . . I'm afraid that's democracy." *Id.* at 13, col. 4.

169. Jackson, *Some Ways and Means Members Saw a Surge in Contributions During Tax-Overhaul Battle,* Wall St. J., Feb. 11, 1986, at 64, col. 1. *See also* Jackson, *supra* note 107. Ernest and Julio Gallo, California winemakers with more than twenty grandchildren and an estimated net worth of $600 mil-

Thus, although the 1986 amendments to the basic income tax provisions of the Internal Revenue Code were hailed as major tax reform, they also became a bonanza for the reformers.[170]

The record abounds with other examples of campaign donations followed closely by favorable legislation.[171] Two essential points emerge. First, the tax "reform" promulgated by Congress is often the reform someone is willing to purchase. Second, many of the purchases are payments to avoid infliction of new economic pain rather than to obtain reform of painful provisions already in existence.

A final example illustrates the value of threatening tax legislation just to raise cash from private interests. As discussed above, excise taxes diminish firms' wealth, and so, firms predictably would be willing to pay politicians not to impose excises.[172] In fact, private interests do just that. Without even proposing an increase in the excise tax on beer,[173] legislators

lion, were upset with a generation-skipping transfer tax provision of Treasury's initial tax reform bill. *See* President's Message to Congress Transmitting Proposed Legislation, 21 WEEKLY COMP. PRES. DOC. 707 (May 29, 1985). The provision would tighten up the generation-skipping tax by making it applicable to direct intergenerational transfers. The purpose of the generation-skipping tax is to ensure that wealth is taxed under the estate tax system at least once every generation. Under prior law, the tax applied to transfers in trust, but not to direct transfers. *See* I.R.C. § 2611(a) (1982). The Gallo brothers hired a lobbyist who successfully convinced Ways and Means to adopt an amendment. *See* Jackson & Birmbaum, *'Gallo Amendment' Backed by Wine Family Opens Multimillion-Dollar Estate-Tax Loophole,* Wall St. J., Oct. 31, 1985, at 64, col. 1.

It is, of course, possible that the amendment was viewed as "good" tax reform. Indeed, the sponsor, Representative Jenkins, characterized the measure as "my little pro-family amendment." *Id.* On the other hand, the Gallo clan has made at least $325,000 in campaign donations, divided fairly evenly between Democrats and Republicans, in the past four federal elections. *Id.* Moreover, according to Treasury's estimates, fewer than 350 taxpayers would benefit from the Gallo amendment. Representative Jenkins, however, denied sponsoring the amendment for any particular individual: "I don't know Mr. Gallo, never met him." *Id.* Despite the limited applicability, the enacted bill retains the Gallo amendment, permitting a one-million-dollar exclusion per transfer for all generation-skipping transfers, except that the final bill eliminated the latter exclusion after 1989. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1433(b)(3), 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085.

170. "President Reagan's effort to overhaul the federal tax system has resulted in a financial windfall for the campaign coffers of most members of Congress' tax-writing committees." Pressman, *supra* note 122, at 1806.

171. *See, e.g.,* M. MALBIN, MONEY AND POLITICS IN THE UNITED STATES—FINANCING ELECTIONS IN THE 1980S 249-56 (1984); L. SABATO, *supra* note 135, at 125.

172. *See supra* notes 98-103 and accompanying text.

173. One report notes that "there hasn't been an increase in the 65-cent-a-case federal tax on beer since the Korean War, and nobody is seriously propos-

have extracted substantial revenue for not taxing. The brewing industry has organized a coalition of brewers and wholesalers to compensate key members of Congress. The coalition regularly invites members of the tax-writing committees to its meetings, paying honoraria of $2,000 per appearance,[174] and thus purchases continued apathy for new beer tax legislation.

It is tempting to blame the entire process of procuring favorable tax provisions and avoiding harmful ones on the private beneficiaries who pay. This is the standard populist perspective: fat-cat lobbyists corrupt some upright but weak legislator. As the discussion here makes clear, however, politicians themselves are principal beneficiaries of the tax process, profiting politically and personally through campaign contributions,[175] speech and appearance fees,[176] and in-kind benefits.[177] Given the benefits to politicians themselves, one should anticipate that they would actively seek contributions rather than wait for lobbyists to come to them. The 1985-86 tax season was in fact noteworthy for the initiative taken by politicians to generate funds,[178] using threats of harmful legislation to extract funds from the special interest PACs.[179] Tax lobbyists said during the latest round of tax reform that they have not seen "such ravenous appetites for contributions in a non-election year before."[180]

III. DURABILITY OF TAXATION CONTRACTS

The taxation process described above is quintessentially

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ing one right now." Jackson, *Brewing Industry Organizes Lobbying Coalition to Head Off Any Increase in U.S. Tax on Beer,* Wall St. J., July 11, 1985, at 52, col. 1.

174. "Members of House and Senate tax-writing committees regularly drop by the coalition's monthly meetings to talk about budget and tax trends, [and] pick up $2,000 appearance fees." *Id.* Although new beer taxes "haven't generated much interest in Congress," the president of the brewery trade association says they "want to be prepared." *Id.*

175. *See supra* notes 119-43 and accompanying text.

176. *See supra* notes 144-55 and accompanying text.

177. *See supra* notes 156-61 and accompanying text.

178. "[L]egislators began tapping contributors for dollars almost immediately after the 1984 campaign came to an end." Pressman, *supra* note 122, at 1807.

179. The arm-twisting is rarely subtle, and often verges on the blatant: "House Republican leaders are sending a vaguely threatening message to business political-action committees: Give us more, or we may do something rash." Jackson, *House Republicans Are Pressing PACs for Contributions,* Wall St. J., June 27, 1985, at 38, col. 3.

180. Jackson, *supra* note 166.

contractual. Both politicians and private interests find themselves better off through exchange. The contracts they write are executory. The politician bargains for money now in exchange for the promise of legislative performance on taxes later. The power to tax that status as a legislator confers can be exercised or not, in the politician's discretion. How the politician uses that discretionary power, however, can be influenced—quite legally—by payments from private parties potentially affected by any taxes enacted or threatened. The consideration for taxing or refraining from taxing varies from votes and campaign contributions to direct payments and in-kind benefits to a politician. In return, the politician will be expected to perform his part of the deal, enacting or defeating tax legislation in the interests of the private contributor.

Viewing the taxation process as an executory contract, in which politicians receive compensation for performing legislative services, leads to consideration of the durability of the contracts. Politicians and private interests can agree to a long-term deal or to a series of shorter-run arrangements. To return to one example noted above,[181] politicians can, and in 1985 did, refrain from increasing the excise tax on beer in return for speaker's fees and other emoluments. If the deal between brewers and politicians only ran through the end of 1985, however, the no-taxation contract would have to be renewed for 1986. If brewers refused in the new year to renew the compensation, politicians then would have an incentive to exercise their taxation power.

As with any contract, the parties generally get what they pay for: long-term deals will cost more, because they involve performance over a greater period. Both sides gain by making long-term deals, all else equal. Longer contracts mean greater certainty for private parties and lower transaction costs for both sides. Longer contracts also have their risks, some particularly pronounced in recent years, which at least partly explains the accelerating rate of tax legislation.[182]

A. THE PRIVATE PARTY'S PERSPECTIVE

1. Breach of Contract

From a private party's perspective, at least three perils are associated with long-term legislative contracts. The first is sim-

181. *See supra* notes 173-74 and accompanying text.
182. *See supra* notes 53-62 and accompanying text.

ply the risk that the politician principally responsible for the legislation or nonlegislation, who has been paid to further certain outcomes, may breach the contract. One would not, however, expect this to be a great risk. The politician who breaches contracts in one legislative session will find the private beneficiaries unwilling to continue contributing in the next session.[183] Moreover, continued welshing would erode the value of the legislator's promise, so that new special interests also would be unwilling to pay in the subsequent session. Politicians, thus, strive to perform their side of the deal.[184]

2. Impossibility of Performance

Simple failure of performance by individual politicians is not as serious a problem for the integrity of long-term tax contracts as two other sources of instability. One is the possibility that the politician will not be in office for the full period covered by the contract. Even if the politician is honest and intends to keep his side of the bargain, he may not remain in a position to do so. A politician may retire early or, more likely, be voted out of office after agreeing to some tax policy for some future period. Performance is then impossible. His successor, who is of course not a party to the deal, has no reason to adhere to his predecessor's policy unless he also receives compensation.

183. This raises the possibility of what is often called the "last-period problem," the lack of incentive that a party has to perform his contractual duties when he knows that he will never have to deal with the other party again. A last-term congresswoman, for example, might breach her taxation contracts with impunity, since she has already been paid for her services and will not be in Congress to solicit further contracts in the future. As the example of Senator Long, *infra* note 184, illustrates, there need be no serious last-period problem in Congress. The most probable explanation is that many, perhaps most, powerful legislators stay on in Washington as lobbyists, and so expect to continue to work with the same people and interests that they encountered while in office. Thus, the last year of their tenure is not really a "last period" at all. The phenomenon of increasing numbers of retired legislators becoming lobbyists is discussed in Easterbrook, *supra* note 132, at 79.

184. The efforts of recently retired Senator Russell Long, "master architect" of the prior version of the Internal Revenue Code, to preserve his text from Reagan reforms have been noteworthy. *See* Birnbaum, *Sen. Long, an Architect of the Income-Tax Code, Is Ready to Protect Handiwork from "Reform,"* Wall St. J., May 7, 1985, at 64, col. 1. Because "[t]he president's tax-overhaul assault comes in the waning days of the senator's tenure, [many observers thought] that impending retirement might free [Senator Long] from the political obligations that have tied him to 'special interest' legislation." *Id.* The observers, however, were wrong. Senator Long still battled "to preserve his favorite tax breaks, including those that encourage business investment, employee stock ownership and domestic oil exploration, a business dear to his home state." *Id.*

Private beneficiaries of tax deals then would have to pay again to obtain the performance already purchased from the outgoing politician. New contracts would follow changes of political office holders.[185] One possible reason for the acceleration in the rate of congressional tax reconsiderations, then, would be an increase in the rate of legislative turnover.

If the durability of contracts between special interests and legislators is related to legislative tenure, tax activity and congressional turnover should be correlated—the less durable the legislator, the less durable the legislation. In fact, some noticeable correlation does exist. Although in the last twenty years there has been no discernible change in the overall incumbency effect for House and Senate members,[186] the tenure of service on the tax-writing committees has shown some interesting variations. For the eighty-ninth Congress in 1965-66, a period of relative stability in the tax area, the average time a legislator had served on the Ways and Means Committee was 4.84 terms.[187] By the ninety-fourth Congress in 1975-76, the average tenure had fallen to 2.81 terms, a drop in longevity of over forty percent. The decrease in length of service on Ways and Means correlates with the acceleration of tax legislation discussed above.[188]

Until the mid-1970s, the Ways and Means Committee characteristically selected legislators from safe districts, thereby

185. The contracts that the new politicians make would not necessarily be mere continuations of the old deals. Changes after the initial bargain was made may mean that the terms offered by others for different tax policies will be more attractive to politicians in positions to influence those policies. Additionally, the voting constituency of the new legislator may differ significantly from that of the old one. In either event, the provisions of the new contracts would differ from those of the old ones. The terms of the new contract are a secondary point, however. Whether or not the new contracts continue the policies contracted for earlier, a new round of tax deals will follow changes in political office.

186. The term "incumbency effect" refers to the likelihood that an incumbent seeking re-election will be returned to office. For the period 1946-1980, the percentage of House incumbents successfully seeking re-election has ranged from eighty to ninety-five percent. For Senate incumbents, the percentage has generally ranged from fifty-five to eighty-five percent. *See* N. ORNSTEIN, T. MANN, M. MALBIN, A. SCHICK & J. BIBBY, VITAL STATISTICS ON CONGRESS, 1984-1985 EDITION, 49-51 (1984).

187. The authors derived this and the following figures concerning average time of service on the Ways and Means Committee and the Finance Committee from the composition of the committees as reported in successive volumes of CONGRESSIONAL INDEX and CONGRESSIONAL DIRECTORY.

188. *See supra* notes 47-66 and accompanying text; *cf.* J. WITTE, *supra* note 3, at 182-90 (outlining tax legislation during the period).

limiting turnover on the committee.[189] Typical of this process was Chairman Wilbur Mills, who presided over the committee almost unopposed at home for sixteen years. The system broke down, however, around the time of the 1975-76 congressional session, following Chairman Mills's nocturnal dip in the Tidal Basin with a stripper, his subsequent revelation of alcoholism, and finally his resignation. During the 1975-76 congressional session, the committee experienced unusual turnover and Chairman Mills was succeeded by Representative Al Ullman.[190] Ullman was chairman for only six years before the incumbent, Representative Dan Rostenkowski, assumed the position.[191]

The turnover phenomenon on the Senate Finance Committee has been similar. The average tenure for Finance Committee members in the eighty-ninth Congress was 5.76 terms. By the ninety-fourth Congress, the average tenure had dropped to 4.22 terms, a fall in tenure of over twenty-five percent. Average tenure fell further to 3.45 terms as of the ninety-seventh Congress in 1981-82. Although the average tenure served does not perfectly foretell how long current legislators will serve in the future, historical turnover provides some information to special interests trying to gauge the likelihood that their favorable legislation will be durable and, accordingly, how much to pay for that level of durability.

For both the Ways and Means and the Finance Committees, average tenure has begun to climb again. For the ninety-ninth Congress in 1985-86, the average tenure for Ways and Means Committee members has risen to 4.39 terms, while average tenure has risen to 5.10 terms on the Finance Committee. The increase in committee tenure by itself might suggest that the accelerating rate of tax legislation should abate as longer-term contracting reappears. Turnover, however, is only one factor that might explain shorter-term contracting.

3. Need for Ancillary Contracts

A third risk associated with long-term contracts derives from the structure of Congress itself, especially the committee system and the House Ways and Means Committee. Constitutionally, tax legislation originates in the House of Representa-

189. T. REESE, *supra* note 116, at 90-92.

190. CONGRESSIONAL QUARTERLY, GUIDE TO CONGRESS 135 (3d ed. 1982) [hereinafter GUIDE TO CONGRESS].

191. *Id.*

tives and then may be amended by the Senate.[192] In the House, the effective power over taxation has traditionally resided almost exclusively in the Ways and Means Committee.[193] Practically, therefore, the chairmen of that committee and of any relevant subcommittees are the most important congressional actors in the tax-contract process. To secure favorable legislation or beneficial legislative inaction, however, a committee or subcommittee chairman must secure the cooperation and votes of others, which requires a series of ancillary contracts. As part of the chairman's contract with private interests, then, he has to muster the votes of many legislators. Moreover, the involvement of Treasury experts, committee staff, and others brings even more players into the game.

The more players in the game, the more risky long-term contracting for tax legislation becomes. Like their prominent committee chairman, less prominent but nevertheless influential actors also resign or lose office, and their successors have no obligation to abide by their predecessors' contracts. Turnover, however, is only part of the problem. More important, the sheer number of persons whose cooperation must be obtained makes it more difficult for committee and subcommittee chairs to deliver on their own taxation contracts. This is particularly true for those actors—congressional staff and Treasury experts, for example—who cannot be compensated for producing favorable tax legislation the way legislators can be.

The difficulty of procuring the cooperation of fellow legislators and other key players thus may provide another explanation for the increasing frequency of tax code amendments. That is, if over time the number of actors in the process has increased and the chairman's control over them has diminished, longer-term contracts predictably would become less popular. Amendments to the tax code would become more frequent.

In fact, numerous changes to the committee system promulgated by House Democrats in the mid-1970s[194] have had the effect of increasing the number of players and of decreasing the chairperson's control. The larger committees were expanded. Ways and Means in particular grew from twenty-five to thirty-seven members.[195] The new system also required committees to establish at least four permanent subcommit-

192. *See supra* note 108.
193. T. REESE, *supra* note 116, at 110-11, 124-26.
194. GUIDE TO CONGRESS, *supra* note 190, at 473.
195. *Id.* at 467.

tees,[196] each with its own chairman. This change greatly fragmented the power previously held by the full committee chairman.[197] The changes effectively established a "subcommittee bill of rights," which included the right of various subcommittees to review a single bill simultaneously.[198] The subcommittee system effectively ended the ability of powerful committee chairs to make good on legislative promises by weakening the committee system.[199]

The role of nonelected employees has grown considerably since 1970 as well. The number of committee employees ballooned from fewer than 400 in 1946 to over 3,000 in 1980, with a significant portion of the increase occurring during the 1970s.[200] Along with the growth in numbers, according to some members of Congress, has come a corresponding growth in the influence of nonelected officials.[201] To a considerable extent, the growth of staff is itself due to the desire to diffuse power previously held by the committee chairperson. When the subcommittee structure was imposed in the 1970s, for example, each subcommittee chairperson and each ranking minority member was authorized to hire a staff person for subcommittee work.[202] In the Senate, staff increases were ordered in response to complaints from junior senators, who wanted some of the same help that more senior incumbents had.[203]

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196. *Id.* at 473.

197. Moreover, the entire Democratic membership of the full committee, not just the chairman, now determines the number and jurisdiction of subcommittees. *Id.*

198. This "multiple referral" resulted in an increase in political infighting. Easterbrook, *supra* note 132, at 58-59. The proliferation of issues following the rise of subcommittees is reflected in the number of votes in Congress itself. In 1960, there were 180 roll-call votes in the House, .7 per work day; in 1970, there were 443 votes, 1.3 per work day; but in 1980 there were 1,276 roll-call votes, 3.9 per day. In the Senate, roll calls have risen from 1.5 per day in 1960 to 3 in 1980. *Id.* at 61.

199. One report quotes a veteran lobbyist:

> There used to be two to five guys on each side [House and Senate] who had absolute control over any category of bills you might want. All you had to do was get to them. Now getting the top guys is no guarantee. You have to lobby every member on every relevant subcommittee and even the membership at large.

Id. at 73.

200. GUIDE TO CONGRESS, *supra* note 190, at 477.

201. One report states that "[t]he growing impact that committee staff is having on legislation has become a subject of concern. There is a feeling among some members [of the House and Senate] that too many decisions are getting away from the persons that were elected to make them." *Id.*

202. *Id.* at 473.

203. *Id.* at 481.

An immediate result of greater staff numbers was an increase in the amount of legislation that the committees reviewed.[204] A greater number of bills, of course, introduces new sources of uncertainty into any long-term promise to provide tax or other sorts of legislative benefits. The uncertainty is particularly pronounced when some of the provisions will embody policy innovations from nonelected staff who cannot legally be paid directly for any legislative promises. The independent role of congressional staffers in whatever legislation results is reflected in increased attention that lobbyists now direct to staff members in addition to elected officials.[205] The heightened independence combined with the increased size of the staff has meant that lobbyists must now deal with a significantly greater number of participants in the tax legislation process.[206]

Given the advantages of contractual durability to all parties, the mid-1970s collapse of the congressional committee system that previously had facilitated long-term contracting is curious. The reasons for the collapse are beyond the scope of this Article, except for the questions the collapse raises about the future of tax deals. If the restructuring of Congress was a one-time event, the flurry of new tax contracts that resulted in the late Seventies and now the Eighties may also be a one-time affair. Ultimately, as turnover stabilizes, committee size levels off, and greater political control is re-established, longer-term tax deals would again be written. It is simply too soon to tell whether the legislative disruptions of ten years ago were aberrant or symptomatic of longer-run trends.

B. The Politician's Perspective

Just as the proliferation of congressional changes in the 1970s created doubt about the likelihood that legislators would perform on longer-term contracts, so did simultaneous changes among private interests make longer-term tax deals less attractive to politicians. A principal disadvantage to a politician who makes tax deals with private interests that are binding into the

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204. *Id.* at 483.

205. *See supra* text accompanying note 161. As one lobbyist complains, " 'until fairly recently many congressmen played active roles in the legislative detail work. Now they can't. Nobody can. The staff does the detail work, and so you must lobby the staff.' " Easterbrook, *supra* note 132, at 75 (quoting Eiler Ravnholt, former administrative assistant to Senator Daniel Inouye of Hawaii).

206. "[W]here before there were a few important individuals on the House and Senate staffs, now there are thousands." *Id.*

future is the possibility that other interests will later emerge and offer more money for a conflicting deal. To the extent that new private interests are expected to emerge tomorrow with cash in hand, politicians will want to preserve their legislative flexibility by making only short-term contracts today.

In fact, the number of payors for legislative favors has grown in the past fifteen to twenty years. Between 1950 and 1967, the number of registered lobbyists was practically unchanged, growing from 430 to 449.[207] By 1984, however, lobbyists numbered about 6,000, and by 1985 the figure had jumped to 8,000.[208] Vigorous growth of PACs has paralleled that of lobbyists. The number of corporate political action committees grew from eighty-nine in 1974 to more than 1,500 in 1983.[209] From the evidence presented above,[210] PACs and lobbyists are effective intermediaries between politicians and private beneficiaries, facilitating the sorts of payments that obtain special legislative consideration. As long as the number of PACs and lobbyists willing to pay is growing, however, politicians predictably would prefer to make shorter-term deals.

IV. TAX LEGISLATION IN 1984-1986 AND BEYOND

The tax reform process that began in 1984 presents in a microcosm many of the features of tax legislation discussed in this Article. What started with the President's call for a Treasury study in January 1984 became President Reagan's tax proposal in May 1985, was substantially altered by the House Ways and Means Committee, and passed by the House in December 1985.

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207. CONG. Q. SERV., LEGISLATORS AND THE LOBBYISTS 28 (2d ed. 1968).

208. *Lobbyists' Price to Persuade Congress Hits $49 Million in '85,* Atlanta J., June 5, 1986, at 8, col. 1.

209.

GROWTH IN CORPORATE PACS

Year	Number of Corporate PACs	Annual % Increase
1974	89	—
1975	139	56.2
1976	433	211.5
1977	550	27.0
1978	784	42.5
1979	949	21.0
1980	1204	26.9
1981	1327	10.6
1982	1467	11.2
1983	1536	4.7

The above figures are taken from L. SABATO, *supra* note 135, at 12-13.

210. *See supra* notes 117-80 and accompanying text.

When the bill moved over to the Senate Finance Committee, Chairman Packwood elected to start from scratch rather than make changes to the House bill.[211] As a result, the Chairman's initial proposal bore scant resemblance to the House version.[212]

When it became apparent that the Packwood version was in trouble in April 1986, hearings were suspended, and an entirely new proposal was considered and passed in June 1986.[213] The Conference Committee then set to work reconciling the vast differences between the House and Senate versions, arriving at a compromise bill in September 1986,[214] which conferred an additional three billion dollars worth of special breaks, in the form of "transition rules," beyond the more than seven billion dollars worth of such breaks already present in the House and Senate versions.[215] After it passed both houses in Septem-

211. *See* Birnbaum, *Hesitant Senate Panel Asks Chairman to Prepare Draft of Tax-Overhaul Bill,* Wall St. J., Jan. 27, 1986, at 2, col. 3.

212. For a comparison of the President's proposal, the House bill, and Chairman Packwood's initial effort, see JOINT COMM. ON TAX'N, 99TH CONG., 2D SESS., TAX REFORM PROPOSALS IN CONNECTION WITH COMMITTEE ON FINANCE MARKUP (Joint Comm. Print 1986) [hereinafter JOINT COMMITTEE PRINT].

213. For a short history of the 1986 tax bill, see Birnbaum, *Tax Bill Saga: How a Pre-Emptive Political Step Became a Plan to Restructure Taxation in the U.S.,* Wall St. J., June 4, 1986, at 62, col. 1.

214. H.R. CONF. REP. NO. 841, 99th Cong., 2d Sess. at III (1986).

215. Birnbaum, *Legislators Finish Tax-Overhaul Draft, Dispensing $3 Billion in Special Breaks,* Wall St. J., Sept. 19, 1986, at 4, col. 2. Birnbaum notes that the "largesse" provided in the 2,000 page bill filed by the Conference Committee on Sept. 18, 1986, was "given out . . . [to] ostensibly smooth the transition from the current tax system to the new one, but the decision about who gets the benefit is often a political one." *Id.* The new rules contained in the Conference bill provided benefits to such interests as two Chrysler plants ($78 million), GM's Saturn Plant ($70 million), Beneficial Corp. ($67 million), a William H. Zimmer power plant in Ohio ($71 million), the Texas Air acquisition of Eastern Airlines ($47 million), and certain insurance companies ($103 million). *Id.* For a more complete listing of the transition rules, see *Conference Agreement Transition Rules and Beneficiaries,* 33 TAX NOTES 75 (1986).

For an illustration that the grant of a transition favor is a political decision, consider the transition rule successfully inserted by Senator Long of Louisiana and Representative Pickle of Texas. Under current law, a taxpayer cannot take a charitable deduction for a contribution to a college or university if in return the taxpayer receives the right to purchase preferred seating at football games and other sporting events. Senator Long and Representative Pickle pushed through a transition rule exempting Louisiana State University (Long's alma mater) and the University of Texas (Pickle's alma mater) from the rule. Gutfeld, *Athletic Gifts to Universities Arouse the IRS,* Wall St. J., Oct. 20, 1986, at 29, col. 3. For another example of the political benefits of transition rules, see Sheppard, *Dole Stands to Benefit from Ruan Trucking Transition Rule,* 34 TAX NOTES 87 (1987).

One casualty of this and other transition rules is the English language. In ber, President Reagan signed the bill reported out of Conference on October 22, 1986, thus enacting the Tax Reform Act of 1986[216] into law.

The roles of four major special interests—insurance, oil and gas, timber, and steel—illustrate the legislative process culminating in the 1986 bill. The first three special interests paid legislators to forestall harmful tax legislation. The steel industry, on the other hand, paid legislators for helpful legislation.

Under the President's original proposal, a life insurance policyholder would have had to include as income the inside buildup on the policy.[217] Fearing that the increased burden would, at the margin, make insurance a less attractive investment vehicle for taxpayers, the insurance lobby contributed generously to tax-writers.[218] By the time the tax bill moved out of the House, the taxation of inside buildup had been eliminated.[219] Other insurance-related benefits also were retained, including the employee's exclusion for employer-purchased term life insurance, tax-free borrowing on life insurance policies, and present law retention of life insurance company reserves.[220] The life insurance industry thus avoided imposition of harmful tax legislation through contracts with the tax-writers.

Oil and gas special interest groups similarly were able to forestall detrimental legislation. The Ways and Means Committee bill initially would have curtailed the depletion allowance and the deduction of intangible development costs

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principle, a transition rule is intended to ease the shock of newly passed legislation. *See* Kaplow, *An Economic Analysis of Legal Transitions,* 99 HARV. L. REV. 509, 520-36 (1986). The Long-Pickle transition rule, however, is a *permanent* "transition" rule.

216. Tax Reform Act of 1986, Pub. L. No. 99-514, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2058.

217. *See* JOINT COMMITTEE PRINT, *supra* note 212, at 107. "Inside buildup" is the increase in the excess of the policy's cash surrender value over the premiums paid during the taxable year.

218. Most members of the Ways and Means Committee as well as the Finance Committee have accepted large sums from insurance PACs. *See* Jackson, *Insurance Industry Boosts Political Contributions As Congress Takes Up Cherished Tax Preferences,* Wall St. J., Oct. 10, 1985, at 64, col. 1.

219. JOINT COMMITTEE PRINT, *supra* note 212, at 107. The Act, as passed, does not tax inside buildup. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 1001-1004, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. §§ 101(d), 130(c), 264(a), 165(h) (West Supp. 1987)).

220. *See* Jackson, *supra* note 218. The final Act did not change these provisions. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 1001-1004, 1011-1013, 1986 U.S. CODE CONG. & AD. NEWS (100 Stat.) 2085 (codified in scattered sections of I.R.C.).

(IDCs).[221] But insurance industry contributions to tax-writers totaled more than $670,000 to tax-writers between 1983 and June 30, 1985.[222] Ultimately, the Senate rewarded the persistence of oil and gas special interests. The Senate Finance Committee proposal retained current law treatment of depletion and IDCs.[223] Furthermore, although the Finance Committee imposed passive income limitations on almost all limited partnerships,[224] an exception was carved out for working interests in oil and gas properties even if the taxpayer does not participate in the investment.[225] Thus, oil and gas interests, like the insurance interests, were able to bid away the initial legislative threats of adverse tax consequences.

Various timber interests also fought harmful provisions that were present in the Ways and Means version, convincing the Senate Finance Committee to restore favorable treatment. The Ways and Means version would have stopped the immediate deduction of expenses for the growing of timber, replacing it with less valuable amortization provisions.[226] The House version also repealed a ten percent tax credit for reforestation expenses.[227] Senator Packwood, a timber-minded Oregonian whose PAC receipts were discussed above,[228] protected timber deductions from the congressional ax and restored the reforestation tax credit.[229]

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221. JOINT COMMITTEE PRINT, *supra* note 212, at 71-72.

222. Jackson, *supra* note 107.

223. *See* JOINT COMM. ON TAX'N, 99TH CONG., 2D SESS., SUMMARY OF TAX REFORM PROVISIONS IN H.R. 3838 AS ORDERED BY THE SENATE COMMITTEE ON FINANCE (May 12, 1986). The Conference Committee adopted the Senate bill's favorable treatment with respect to depletion. With regard to IDCs, however, the Committee adopted a compromise, only slightly less favorable than prior law. The Act increases the required capitalization from twenty percent to thirty percent of total IDCs and the amortization period from three to five years. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 411, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 291 (West Supp. 1987)).

224. Essentially, losses could only offset income from activities in which the taxpayer does not materially participate. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 469 (West Supp. 1987)).

225. *See* S. REP. NO. 313, 99th Cong., 2d Sess. 744 (1986). The Tax Reform Act retained the exception for working interests in oil and gas properties. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 469 (West Supp. 1987)).

226. *See* JOINT COMMITTEE PRINT, *supra* note 212, at 67.

227. *Id.*

228. *See supra* note 125 and accompanying text.

229. *See* H.R. CONF. REP. NO. 841, 99th Cong., 2d Sess. at II-117 to -118

In addition to the examples of payments to avoid threatened legislation, the 1986 bill is rife with purchased legislation. One small example speaks volumes. Under current law, taxpayers could not generally deduct the cost of conventions outside North America, in places like Bermuda and certain Caribbean Sea countries.[230] The Senate Finance Committee bill treated Bermuda as being within the North American area and permitted deductions if "the President certifies that such treatment is in the national security interest of the United States."[231] The apparently tenuous connection between national security and a convention of the argyle socks trade association in Bermuda becomes clearer once one realizes that Senator Packwood and his wife were flown to Bermuda for "sensitive and important discussions" in July 1985, after which the Senate bill enhancing Bermuda's tax status appeared.[232] Ultimately, however, the Conference Committee bill did not adopt the Senate's Bermuda provision.[233]

Another example of a purchased beneficial tax provision, however, survived the conference agreement and became law. As proposed by the Senate Finance Committee and adopted in the Tax Reform Act, the steel industry stands to receive about $500 million in cash from the government for unused investment tax credits.[234] Although the Act eliminates the investment tax credit,[235] a special "transition rule"[236] permits the

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(1986). The Act, as adopted, retains the prior favorable law with respect to expensing preproductive costs and the ten percent reforestation credit. *Id.*

230. Under § 274(h)(6) taxpayers could not deduct as expenses the costs of conventions in Bermuda and certain Caribbean countries unless the countries met specified requirements. *See* I.R.C. § 274(h)(6) (West Supp. 1986); H.R. CONF. REP. NO. 814, 99th Cong., 2d Sess. at II-31 (1986).

231. S. REP. NO. 313, 99th Cong., 2d Sess. 70 (1986).

232. *See* Birnbaum, *Senate Panel's Overhaul Bill Doubles as Spoils System to Provide Tax Favors,* Wall St. J., May 16, 1986, at 4, col. 2.

233. *See* H.R. REP. NO. 841, 99th Cong., 2d Sess. at II-31 to -32 (1986).

234. *See* Birnbaum, *supra* note 215, at 4, col. 2; Birnbaum, *Finance Panel Head Claims 31 Senators Will Help Oppose Tax-Bill Amendments,* Wall St. J., May 30, 1986, at 3, col. 2; Birnbaum, *Tax Break for Steel Industry Inserted in Legislation Sparks Senators' Protests,* Wall St. J., May 15, 1986, at 2, col. 3.

235. Tax Reform Act of 1986, Pub. L. No. 99-514, § 211, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 49 (West Supp. 1987)).

236. *See supra* note 215. The final bill contained approximately 340 "transition rules," providing $10.6 billion in special benefits to particular interests. Birnbaum, *supra* note 215. The steel industry benefit was carried over from the Senate bill, which together with the House bill conferred over seven billion dollars in special tax breaks, *id.*, for supporters of the tax-writing committees. The Conference Committee added another three billion dollars of

steel companies a fifteen year carryback of unused investment tax credits[237] enabling them to receive a cash refund. The immediate cash payment offers better tax treatment than steel companies would experience under the prior law.[238] In general, industries with unused tax credits do not receive refunds for unused credits.[239]

The 1986 Tax Reform Act has been hailed as the most significant tax legislation in the past twenty-five years.[240] The rhetoric, however, cannot disguise what the voluminous act reveals. Nobody pays for simplification. Like its predecessors over the past twenty years, the new code will do nothing to simplify or stabilize the current system. Even those provisions that appear to simplify are misleading. For example, the capital gains preference is eliminated, but the capital gains/ordinary income distinction is retained in anticipation of future tax increases.[241] The Act reduces the fourteen current individual tax rates to two—fifteen and twenty-eight percent.[242] Whether faced with fourteen or two rates, a taxpayer will still consult a table accompanying the Form 1040 to compute taxes due. Moreover, because of the phase-out of the fifteen percent rate above a specified income level, the marginal rates after 1987 actually range up to thirty-three percent on some portions of a taxpayer's income and must be computed with reference to two or three different income figures rather than the simple

"transition rules" to the final bill to "ease its passage" by the full Congress. *See id.*

237. Tax Reform Act of 1986, Pub. L. No. 99-514, § 212, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085.

238. Under the prior law, unused credits could only be carried back three years and forward fifteen years. I.R.C. § 39 (West Supp. 1986). The steel companies thus would have had to wait for future profitable years to offset the credits against tax liability.

239. A similar transition rule applies to farmers, but it limits the carryback to $750. Tax Reform Act of 1986, Pub. L. No. 99-514, § 213, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085.

240. Fessler, *Ways and Means Finishes Tax Code Overhaul,* 43 CONG. Q. WEEKLY REP. 2483 (1985); *see also* Remarks on Signing HR 3838 into Law, 22 WEEKLY COMP. PRES. DOC. 1423, 1423, 1425 (Oct. 27, 1986) (referring to the bill as "the most sweeping overhaul of Tax Code in our nation's history" and as "a revolution").

241. *See* S. REP. No. 313, 99th Cong., 2d Sess. 169-70 (1986); *A Complete Guide to the Tax Reform Act of 1986,* Fed. Taxes (P-H) ¶ 301 (Oct. 18, 1986).

242. Tax Reform Act of 1986, Pub. L. No. 99-514, § 101, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 1 (West Supp. 1987)).

"taxable income" figure in use now.[243]

Moreover, the Act preserves assignment of income possibilities, preserves special treatment for a variety of industries, such as oil and gas, timber, and insurance, and adds several bizarre provisions that have tax planners panting in anticipation. The new provision aimed at curtailing tax shelters offers new challenge to the best and brightest tax professionals of our day.[244]

CONCLUSION

The traditional public finance theory of taxation is of limited help in understanding the acceleration of tax change. In the traditional theory, taxation is a response to the need for an efficiency-minded government to provide goods that the private market cannot provide or to correct externalities generated by private markets. This model ignores many aspects of the real world of taxation, in which politicians take the initiative in soliciting funds—for themselves, not for production of public goods. Politicians' personal demands—whatever their concern with private externalities—also drive the tax legislation process.

The variables discussed in this Article may not explain all of the acceleration in tax reform. All other things equal, however, the process of contracting for particular tax legislation described here would unquestionably increase the amount of tax change. Like so many other kinds of regulation, politicians provide taxation and nontaxation to those willing to pay for their preferred tax policy. One routinely observes salient aspects of the tax-contracting process: payments made by private beneficiaries to politicians in a position to influence tax outcomes, with favorable legislation or legislative forebearance delivered in return.

The willingness of the parties to contract depends, however, on the likelihood of the politicians' keeping their part of the bargain. One principal impediment to politicians' performing executory contracts is that they may be voted out of office. As the turnover of incumbents increases, private beneficiaries will shorten the terms of the contracts offered, instead prefer-

243. *See* Hevener, *The Hidden Fifty Percent Marginal Rates of H.R. 3838*, 31 TAX NOTES 1341 (1986).

244. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 (codified at I.R.C. § 469 (West Supp. 1987)).

ring to renegotiate a series of shorter-term deals. Turnover on the tax-writing committees did in fact rise in the past decade or two. Predictably, the rate of tax reconsideration has proceeded apace.

A second impediment to politicians' performing their contracts is the need to secure votes and other types of cooperation from a large number of actors. If it becomes more difficult to control others whose approval is needed, less contracting for long-term tax legislation will result. In fact, diminished control over other players in the tax game has been frequently noted by congressional observers. Likewise, an increase in the sheer number of persons involved in legislating, such as that occurring in the 1970s with tax legislation, will enhance the relative attraction of short-term contracts. Finally, from the politician's standpoint, increasing numbers of lobbyists and PACs willing to pay for legislative action and inaction has also made shorter-term tax deals more attractive.

In the end, one must ask what difference accelerating tax legislation makes. The discussion here has not tried to analyze all the economic effects of periodic tax revision. There are wide economic implications of accelerating tax change.[245] Use of resources, including politicians and lobbyists, in contesting the share of taxes to be paid by particular interests diverts those resources from productive to redistributive activity.[246] Moreover, the possibility of future changes in the "rules of the game" that will tax away more of one's wealth creates a disincentive to wealth-creation in the first place.[247] Uncertainty alone is a disincentive to productive activity. A survey of the United States Chamber of Commerce's membership, taken while the tax bill was being debated, found that forty-two per-

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245. That is to say, there are broad implications of a system in which "the allocation of tax shares among individuals and groups in the economy and the choice of tax instruments that generate the imputations of such shares are considered 'up for grabs' during each and every budgetary period." G. BRENNAN & J. BUCHANAN, *supra* note 72, at 190.

246. As one discussion explains, the tax code

> creates wealth transfers, and interest groups will accordingly have an incentive to spend resources in efforts to prevent part of their wealth from being taxed away or to shift some of their liabilities to other groups. They organize, invest in lobbying activities, contribute to political campaigns, advertise their point of view, and so forth. These expenditures reduce the welfare of society as a whole because they are made in pursuit of income redistribution rather than in income-increasing activities.

Shughart, *supra* note 82, at 4.

247. This point is discussed in McChesney, *supra* note 82.

cent have delayed investment decisions because of uncertainty over the final shape of the bill.[248] Other private and government surveys similarly showed great weakness in real investment spending for 1986.[249]

Furthermore, the next time Congress attempts to encourage behavior in the private sector through tax incentives, it will have to raise the ante because taxpayers will be more mistrusting. For example, those who have invested in capital assets expecting a maximum tax of twenty percent on any gain when those assets are sold may now face a twenty-eight percent rate on any gain. In the future, if Congress were again to lower the rate on capital assets, some taxpayers would be reluctant to change their spending patterns for fear that the rate might again be increased before they were ready to sell. To attract those taxpayers, Congress will have to lower the initial tax rate even more.

Is the Tax Reform Act of 1986 the end, or even a pause, in a cycle of annual tax reform? The inexorable march toward complexity and revision is hardly slowed by the current act and will undoubtedly continue. There are ominous signs from both the White House and Capitol Hill that the new Congress will find tax "reform" as attractive as the old.[250] Senator Bentsen has already proven himself a worthy heir to Senator Packwood as Chairman of the now-Democratic Senate Finance Committee.[251] Over the next few years, tax changes are likely to be

248. Rahn, *Making Sure Tax Reform Works*, Wall St. J., June 26, 1986, at 30, col. 3.

249. *Id. See also* Clark, *Taxes Can Be Expensive Even Before You Pay Them*, Wall St. J., Aug. 12, 1986, at 29, col. 3 (tax reform "has greatly increased economic uncertainty at a time when there already was plenty of it around").

250. *See, e.g.*, Boyd, *Reagan May Seek Tax Bill Changes After Enactment*, N.Y. Times, Aug. 19, 1986, at 1, col. 1; Congressman Rostenkowski has said that "[e]veryone knows we will eventually need a tax increase." *Locking In the Pols*, Wall St. J., Sept. 16, 1986, at 28, col. 1. Senator Bentsen agrees: "If nothing else, you're going to have a very major technical-corrections bill, and that's the least you're going to have." Birnbaum, *In Turning to Deficit, Congress May Tinker with the Taxes Again*, Wall St. J., Aug. 18, 1986, at 1, col. 1. So does the chief of staff of the Joint Conference Committee on the last tax act, who estimates that the next round of tax reform will come within less than a year. Burns, *Tax Revision Made Not So Easy*, Wall St. J., Nov. 13, 1986, at 32, col. 3.

251. The *Washington Post* broke a story that Senator Bentsen offered 200 Washington lobbyists and political action committee directors the opportunity to have breakfast with him once a month as the "Chairman's Council." The cost of the monthly breakfasts was to be a $10,000 contribution to the Senator's campaign fund. Bentsen invited the lobbyists noting, "I will be relying on members of the Chairman's Council for advice, assistance and early financial

termed "technical corrections." Whatever the name, however, special interests will provide the feed as long as tax-writers and other legislators belly up to the trough.

support crucial to a successful campaign." Many lobbyists were reluctant not to join the Council, fearing a loss of access to the Senator. Edsall, *Breakfast With the Senate Finance Chairman—for $10,000,* Wash. Post, Feb. 3, 1987, at A1, col. 1. Senator Bentsen offered to hold multiple breakfasts if the Council got too large. *Id.* The reaction to the *Washington Post* story was so strong that Senator Bentsen decided to disband the Council and return the contributions of the estimated forty lobbyists who had already made contributions. Senator Bentsen's predecessor, Senator Packwood, had a similar council but only charged $5,000 for the privilege. Timberlake, *Revelation of Members' Breakfast Clubs Renews Controversy Over PACs' Influence,* 34 TAX NOTES 541 (1987); *Senator Scraps $10,000 Breakfast,* Atlanta J., Feb. 6, 1987, at 1, col. 1.