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Introduction

Joseph M. Dodge
1@1.com

Steve R. Johnson
2@2.com

Jeffrey H. Kahn
23@23.com

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INTRODUCTION

Joseph M. Dodge, Steve R. Johnson & Jeffrey H. Kahn

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INTRODUCTION TO ONE-HUNDRED YEARS OF THE FEDERAL INCOME TAX

JOSEPH M. DODGE*, STEVE R. JOHNSON** & JEFFREY H. KAHN***

Income taxation in the United States got off to a less than auspicious start.¹ A few American colonies experimented with taxes that crudely attempted to reach certain income from business and professional activities during the 17th and 18th centuries.² Secretary of the Treasury Alexander Dallas urged adoption of an income tax during the War of 1812, but that conflict ended before action was taken on his proposal.³

Both sides adopted income taxes during the American Civil War.⁴ The victorious North repealed its tax shortly after the war ended.⁵ About a decade after the tax had been repealed, the Supreme Court upheld the constitutionality of the tax in the *Springer* case.⁶

In 1894, a federal income tax system was again enacted. Especially compared to what we have now, that tax was a model of simplicity. As applied to individual taxpayers, it imposed a flat rate of two percent on any income over \$4000.⁷ A year later, in the famous (or infamous) *Pollock* decisions, the Supreme Court, effectively overruling *Springer*, struck down the federal income tax as unconstitutional.⁸

In 1909, Congress proposed a constitutional amendment to overturn *Pollock*. This amendment was ratified on February 25, 1913 as

* Stearns Weaver Miller Weissler Alhadeff & Sitterson Professor, Florida State University College of Law.

** University Professor, Florida State University College of Law.

*** Charles W. Ehrhardt Professor & Associate Dean for Academic Affairs, Florida State University College of Law.

1. For discussion of the early history of taxation in the United States, see JOSEPH M. DODGE, J. CLIFTON FLEMING, JR. & ROBERT J. PERONI, *FEDERAL INCOME TAX: DOCTRINE, STRUCTURE, AND POLICY* 3-11 (4th ed. 2012).

2. See generally ROBIN L. EINHORN, *AMERICAN TAXATION, AMERICAN SLAVERY* (2006) (discussing tax systems of the American colonies); see also HAROLD DUBROFF, *THE UNITED STATES TAX COURT: AN HISTORICAL ANALYSIS* 1-2 (1979).

3. DUBROFF, *supra* note 2, at 2.

4. *E.g.*, Act of August 5, 1861, ch. 45, § 49, 12 Stat. 292, 309; Act of July 1, 1862, ch. 119, § 89, 12 Stat. 432, 473; *Tax History Museum: 1861–1865: The Civil War*, TAX ANALYSTS, <http://www.taxhistory.org/www/website.nsf/Web/THM1861?OpenDocument> (last visited Feb. 1, 2014) (describing Confederacy income tax).

5. Act of July 14, 1870, ch. 255, § 6, 16 Stat. 256, 257.

6. *Springer v. United States*, 102 U.S. 586 (1880) (holding that the Civil War income tax was not subject to the requirement, imposed by Article I, Section 2, Clause 3 of the U.S. Constitution, that a federal “direct tax” had to be apportioned among the states in proportion to population).

7. Act of August 27, 1894, ch. 349, § 27, 28 Stat. 509, 553.

8. *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429 (1895), *aff’d on reh’g*, 158 U.S. 601 (1895) (holding that the income tax, in taxing income from property, was a non-apportioned direct tax).

the Sixteenth Amendment, which provides: “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.” Shortly after the ratification of the Sixteenth Amendment, Congress enacted the Revenue Act of 1913 and, thus, the modern federal income tax was born.⁹

Few events have been more important in shaping contemporary American life than the creation and development of the income tax. “No other branch of the law touches human activities at so many points” as does income tax law.¹⁰ Income tax considerations bear on marriage, children, home, work, and the numerous other activities, transactions, and decisions fundamental to life. Income tax planning is crucial to businesses large and small. The modern welfare-defense-regulatory state would be impossible without the enormous and predictable flows of revenues provided mainly by the income tax. Whether the effects of the federal income tax are desirable can be debated. The pervasiveness of these effects cannot be.

Thus, whether as celebration or lamentation, the centennial of the modern federal income tax is an occasion to mark. To do so, we at Florida State hosted an array of distinguished experts who offered perspectives on what we have learned in the last 100 years and where we should (or will) go in the future. Joining us for the occasion, as principal presenters and as commentators, were Steven Bank, Joseph Bankman, David Gamage, James Hines, Jr., Douglas Kahn, Leandra Lederman, Gregg Polsky, Clarissa Potter, Chris Sanchirico, Daniel Shaviro, and Lawrence Zelenak. Although they need no introduction, their institutional affiliations are listed at the end of this Introduction.

We convened on March 1 and 2, 2013. Eight original articles and essays examined historical developments, current features, and future possibilities as to the federal income tax. First, authors presented their work, then designated commentators offered their perspectives, then all conference participants participated in rich and free-wheeling debate. The pieces appearing in this symposium issue were enriched by this stimulating discussion.

Beginning this symposium issue, Professor Daniel Shaviro explores *The Forgotten Henry Simons*. Simons is a household name with tax scholars on account of his well-known definition of personal income as the “algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in value of the store of property rights between the beginning and end of the period in ques-

9. Act of October 3, 1913, ch. 16, 38 Stat. 114. Previously, the federal government had enacted a corporate income tax. Act of August 5, 1909, ch. 6, § 38, 36 Stat. 11, 112. The Supreme Court upheld the corporate income tax as a uniform “indirect” tax in *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911).

10. *Dobson v. Commissioner*, 320 U.S. 489, 494-95 (1943).

tion.”¹¹ This definition of personal income, now referred to as the Haig-Simons definition, is still used as a standard and remains important in modern tax scholarship.

Professor Shaviro explores the man behind the definition. He provides a brief overview of Simons’ “meteoric” career. The article then moves to a discussion of the seemingly contradictory nature of some of his opinions. Simons described himself as “severely libertarian.” He generally denounced government economic regulation and was the intellectual leader of the pro-free market law and economics movement at the University of Chicago Law School. Yet he also was a proponent of “drastic progression” in a broad-based income tax. Professor Shaviro explores these apparently contradictory views and attempts to explain why Simons may have held them. Finally, while acknowledging that Professor Simons favored an income tax system over a consumption tax system during his lifetime, Professor Shaviro attempts to discern what Professor Simons might think today on that issue.

In *When We Taxed the Pyramids*, Professor Steven Bank explores the dividends received deduction.¹² This deduction allows a corporation to deduct from its income an amount equal to a certain percentage (or all) of the dividends that it receives from other domestic corporations. The article examines the historical development of the deduction to explain how we ended up with the current tax treatment of such dividends. Professor Bank focuses on the original purpose for taxing intercorporate dividends, which was to discourage the formation of corporate “pyramids” or groups of corporations controlled by one parent holding corporation. These structures were viewed as abusive and facilitated the concentration of too much wealth and power in a small group of owners.

The article explores the political shift in attitude over time regarding the concern of multi-level corporate groups and the gradual acceptance of the pyramid structure. Professor Bank uses the fall and rise of the corporate consolidated return to illustrate this shift of opinion. This leads us to where we are today, with a dividends received deduction for corporations that does not appear to fulfill any policy rationale. Professor Bank concludes the article by proposing reforms that would better align the treatment of intercorporate dividends with the policy justification for allowing a deduction for such income.

The individual income tax has increasingly grown more complex over its 100-year history. In *Some Income Tax Simplification Proposals*, Professor Joseph Dodge presents explanations of how complexity has come about, while offering reasons why simplification,

11. HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938).

12. I.R.C. § 243.

especially for individual and small-business taxpayers, has merit. Professor Dodge then offers an array of simplification proposals, broken down into one list of proposals that do not entail significant reform from the policy perspective and a separate list of commonly mentioned reform proposals that would also advance the cause of simplification. The lists are not exhaustive; for example, simplification of capitalization doctrine and capital recovery methods (including depreciation) is not considered.

Many simplification proposals made by Professor Dodge are aimed at low to moderate individual taxpayers. For example, the taxable income computation could be simplified by eliminating the different treatment of various categories of deductions. Low-income allowances could be simplified by eliminating the separate rate schedules for unmarried individuals and heads of household, plus collapsing the existing standard deduction, personal exemption, and dependency exemptions into a single subsistence deduction based on family size. Similarly, the earned income credit, the child credit, and the household and dependent care credit could be combined into a single dependent-care allowance for the working poor. Another type of simplification entails elimination of (1) subjective tests, (2) assorted fact-intensive inquiries, (3) meaningless distinctions, and (4) pointless computations. Along these lines, the definition of “dependent” could be simplified by eliminating “support” tests, the *Duberstein* definition of “gift”¹³ could be replaced by the gift tax definition of gift,¹⁴ depreciation (and basis adjustments) could be disallowed on business or investment use of personal residences, the distinction between tax alimony and child support could be abolished, and various borderline personal-business costs could be disallowed. Ranging further afield, Professor Dodge floats notions of cash accounting for small business (including avoidance of inventory accounting), portfolio accounting for publicly traded securities held by an individual, and simplification of the income tax rules involving gratuitous transfers, grantor trusts, and estates. Also considered are various reform proposals pertaining to capital gains, the personal deductions, and the horrendously complex system of taxing retirement income deferrals.

In *A Proposed Replacement of the Tax Expenditures Concept and a Different Perspective on Accelerated Depreciation*, Professor Douglas Kahn revisits the debate on tax expenditure budgets, a concept that he has previously criticized.¹⁵ The tax expenditure concept rests uneasily on the premise that there is an “ideal” income tax system and

13. See *Commissioner v. Duberstein*, 363 U.S. 278, 285-86 (1960) (defining gifts excludible from income taxation as transfers animated by the donor’s “detached and disinterested generosity” (quoting *Commissioner v. LoBue*, 351 U.S. 243, 246 (1956))).

14. See I.R.C. § 2512(b) (defining gifts by reference to the extent by which the value of the transferred property exceeds consideration rendered for the transfer).

15. Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661 (1992).

that any departures from that ideal system should be scrutinized to see if they are justified. In this essay, Professor Kahn contends that a major flaw in the tax expenditure concept is its view that the current tax provisions can be divided into two camps in black and white terms. That is, a provision either is a departure from the ideal system or it is within the system; there is no middle ground. To the contrary, Professor Kahn contends that the tax system is too sophisticated for such a crude classification to be appropriate. Instead, he maintains that the tax system should be analyzed under a more differentiated multivariate standard.

Professor Kahn reviews the tax law's allowance of depreciation deductions as an example of the flaws in the tax expenditure concept. Taxpayers generally must capitalize business costs for items that will be used for more than one year (in contrast to deducting those costs immediately). The system for annually deducting a portion of the cost is referred to as depreciation. There has been much debate over the question of how the amount of depreciation deductions should be determined. Current tax law permits an accelerated method of depreciation (i.e., greater amounts deducted in the earlier years of use of the item) for some properties. One of the government's tax expenditure budgets treats depreciation in excess of what would be allowed under the straight-line method as a tax expenditure. Professor Kahn adopts an approach that shows that acceleration is not *per se* inconsistent with normal tax principles, but he does emphasize that his conclusion does not mean that accelerated depreciation is the proper system to employ.

In *The End of Cash, the Income Tax, and the Next 100 Years*, Professors Jeffrey Kahn and Gregg Polsky take the occasion of the income tax centennial to question how future technology might improve tax compliance under the income tax system, although they note that such technology ironically may also signal the end of the income tax. Professors Kahn and Polsky propose that future technological advances in payment systems may shrink the cash economy down to an immaterial size. They suggest that such a world would lead to an increase in tax compliance since the government would easily be able to track income transfers between taxpayers, which should lead to increased tax compliance. The shrinkage of the tax gap would make the income tax system more efficient, thereby strengthening the system.

Those same technological advances in payment systems also could lead to the demise of the income tax. For a variety of reasons, many economists and policy experts advocate the move from an income tax system to one that focuses more intently on consumption. One difficulty with such a move is the inability to introduce significant progressivity to such a system. Widespread and exclusive electronic payment systems, however, could change that and allow the government to tailor a consumption tax system with progressive

rates, thereby leading to the end of the income tax system that we celebrate today.

Professor David Gamage's contribution to the symposium—*On the Future of Tax Salience Scholarship: Operative Mechanisms and Limiting Factors*—builds on his earlier work, with Professor Darien Shanske, that reviewed the developing literature on tax salience.¹⁶ “‘Tax salience’” refers to how the presentation of tax prices affects taxpayer behavior. In other words, tax salience measures how taxpayer behavior departs from key assumptions of neoclassical economic theory.”¹⁷ Professor Gamage's hope is that such analysis will further aid the development of scholarship and policymaking in the area. While he concedes that the body of literature is not quite there yet, Professor Gamage believes that the area will soon be developed enough to provide substantial policy recommendations for our federal income tax system.

Appropriately, most of the attention of this symposium is directed at the substantive rules of federal income taxation, the policies behind them, and the alternatives to them. But procedural rules—the provisions governing resolution of controversies as to the meaning and application of the substantive rules—also are part of the story of the first 100 years and of the foreseeable future.

Professor Steve Johnson takes a panoramic look at the procedural rules in *Reforming Federal Tax Litigation: An Agenda*. He identifies 12 key events and trends—statutory, regulatory, and judicial—that have shaped the current federal tax procedure and collection regimes. He finds that four sets of values have driven these events and trends: providing remedies for taxpayers and third parties that are both fair and perceived to be fair, protecting the revenue, achieving decisional consistency, and promoting process efficiency, reducing costs, and reducing delays.

Applying these criteria, Professor Johnson proposes an array of reforms to federal tax litigation, as to available fora, available forms of action, and prerequisites to suit. His recommendations include expanding the Tax Court's jurisdiction to give it nearly plenary civil tax jurisdiction, abolishing the Court of Claims' tax jurisdiction, abolishing nearly all of the so-called TEFRA partnership audit and litigation regime, revising (though not abolishing) Collection Due Process hearings and litigation, and facilitating tax refund suits by allowing taxpayers to sue after paying only part of assessed liabilities (instead of having to pay the full assessment as a precondition of suit).

The symposium issue concludes with Professor Larry Zelenak speculating on the question of whether Florida State University College of Law will hold another tax symposium in the year 2113 “cele-

16. David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 TAX L. REV. 19 (2011).

17. *Id.* at 19.

brating” the 200th anniversary of the federal income tax. That is, will the income tax survive for another 100 years? In *Will the Federal Income Tax Have a Bicentennial?*, Professor Zelenak argues that the income tax system is defined by more than just its base. He notes that there are several defining features of the income tax that have nothing to do with its base. Believing that many of these features will remain intact, even if the income base changes, leads Professor Zelenak to conclude that it is arguable that the public would still consider our system to be an income tax—that is, that the label “income tax system” has become broader than just the income base. If true, it is likely that Florida State University College of Law will be issuing an all-digital, holographic symposium issue in 2113 celebrating (or lamenting) another 100 years of the income tax.

We at Florida State are deeply grateful to all the conference participants for their enthusiasm and insights. We present the articles and essays in this symposium issue in the hope and belief that they will stimulate further thought and debate as the United States embarks on its second century of the federal income tax.

FEATURED PRESENTERS AND COMMENTATORS
“One-Hundred Years of the Federal Income Tax”
Florida State University College of Law
March 1 & 2, 2013

Steven A. Bank, Paul Hastings Professor of Business Law, UCLA School of Law

Joseph Bankman, Ralph M. Parsons Professor of Law and Business, Stanford Law School

Joseph M. Dodge, Stearns Weaver Miller Weissler Alhadeff & Sitterson Professor, Florida State University College of Law

David Gamage, Assistant Professor of Law, University of California, Berkeley School of Law

James R. Hines, Jr., L. Hart Wright Collegiate Professor of Law and Richard A. Musgrave Collegiate Professor of Economics, University of Michigan

Steve R. Johnson, University Professor, Florida State University College of Law

Douglas A. Kahn, Paul G. Kauper Professor of Law, University of Michigan School of Law

Jeffrey H. Kahn, Charles W. Ehrhardt Professor and Associate Dean, Florida State University College of Law

Leandra Lederman, William W. Oliver Professor of Tax Law, Indiana University Maurer School of Law

Gregg D. Polsky, Willie Person Mangum Professor of Law, University of North Carolina School of Law

Clarissa Potter, Deputy Tax Director, AIG; former Deputy Chief Counsel, Internal Revenue Service

Chris William Sanchirico, Samuel A. Blank Professor of Law, Business, and Public Policy, University of Pennsylvania Law School

Daniel Shaviro, Wayne Perry Professor of Taxation, New York University School of Law

Lawrence A. Zelenak, Pamela B. Gann Professor of Law, Duke Law School