TAX SIMPLIFICATION THROUGH CUMULATIVE AVERAGING

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Complications in the enactment and administration of income tax laws as they generally exist at present arise very largely from the need to answer four types of questions: (1) Is it income? (2) Whose income is it? (3) What kind of income is it? and (4) When is it income? A surprisingly large proportion of the questions that arise and generate involuted legislation and complicated administrative rulings have to do with the last two of these questions, questions which essentially have little to do with the basic philosophy of the income tax, and which fundamentally should be irrelevant to the assessment of a properly designed income tax.

The question as to the kind of income that an item represents has to do very largely with the special favors extended to income designated as capital gains. This is not the place to attempt to answer all of the varied and intricate specious arguments advanced in favor of such special treatment.[1] Suffice it here to say that the one argument that has some semblance of substance in the context of a general income tax assessed annually at progressive rates, to wit, that gains accumulated over a long period and realized in a single year may subject the taxpayer to unreasonably high bracket rates if no allowance is made, is largely vitiated as soon as there is available an adequate averaging of income, so that the effective rate ultimately depends not on the income of a single year but on the general level of income over a period of several years. The difficulty heretofore with such averaging devices has been that either they were not fully effective in overcoming the disadvantages of "lumpy" income, or they required extensive record keeping, or fairly elaborate computations, or gave undesirably capricious results in special cases. Cumulative averaging, or perhaps more descriptively, cumulative assessment, is a method of averaging that is at once simple, complete, and free from capricious impacts, and its adoption should completely overcome whatever rational hesitation there may be to the elimination of capital gains as a special category of income, allowing receipts in this form to be treated on the same basis as any other.[2]

The question as to when an item is income is one that in the long run has little if anything to do with a taxpayer's over-all ability to pay, and in any properly designed tax should be a matter in which neither the taxpayer nor the Treasury should have any substantial interest. The fact that under the present law the timing of income

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[1] *See, e.g.*, L. Seltzer, The Nature and Tax Treatment of Capital Gains and Losses (1951).

[2] The basic concept of cumulative averaging was first developed in Vickrey, *Averaging of Income for Income Tax Purposes*, 47 J. Pol. Econ. 379 (1939). The scheme was developed further and described more fully in W. Vickrey, Agenda for Progressive Taxation 172-95, 285-87, & 417-27 (1947).

does so make a substantial difference is amply attested to by the multitude of rules, distinctions, accounting specifications, and the like that permeate the regulations, and the amount of contention that arises between taxpayer and Revenue Service over these matters. That even so the results are not always considered adequately equitable is evidenced by the fact that at long last limited and complicated forms of averaging have been introduced to take care of the more extreme cases of inequity. But what has been done here has hardly scratched the surface of what can be done through averaging to make the income tax more equitable, and, far from taking advantage of the potentials for simplification that inhere in averaging, the methods of averaging adopted have themselves been a source of added and excessive complication.

Cumulative averaging is a method of assessing the income tax on the basis of the aggregate income of an individual over a period extending from some fixed initial year to the current year, in such a way that any shifting of items of income or of deductions from one year to another within this over-all period will have no effect on the over-all tax burden borne by the individual. Provided only that checks are provided through a final valuation of assets at the end of the last year of the averaging period, as at the death of the taxpayer, and the bringing to account of accruals of income thus revealed, so that income may not be shifted into or out of the period as a whole, the taxpayer may be left free to carry on his accounting in any self-consistent way he sees fit, deciding for himself such matters as rates of depreciation or amortization, whether to expense or capitalize outlays, when to date transactions, whether to accrue discounts, and the like. More important, taxpayers will be free to enter transactions at any time without having to take into account any likelihood that the timing or nominal form of the transactions would have a significant effect on his ultimate over-all tax liability. Cumulative assessment, coupled of course with full taxation of capital gains and full deductibility of losses, is thus a means of freeing the taxpayer completely from the pervasive baleful influence of the income tax as it exists currently. There will be no lock-ins, no need to cast transactions in unnatural forms, and no need to consult a tax expert before every important transaction!

One might think that in order to accomplish all this the assessment of tax on a cumulative basis would itself have to be fairly complicated. In practice, however, cumulative assessment turns out to be a very simple computation insofar as the taxpayer is concerned. By making use of tax tables quite similar to those now used for the annual tax computation, the computations required of the individual taxpayer are far simpler, in fact, than those required to take advantage of most of the averaging provisions that have thus far been enacted. Indeed, these computations turn out to be so simple that taxpayers in the income classes which now generally itemize deductions would have no difficulty in applying the cumulative assessment procedure as a normal routine rather than as an exceptional or optional extra procedure. This in itself is an important further simplification in that it removes from the taxpayer the burden of having to decide whether he should attempt to use the averaging provisions for any particular year.

Conceptually, cumulative assessment amounts to considering all previous payments on account of income tax on income reported for years included in the cumulation period as interest-bearing deposits in a tax guarantee account. The interest at an appropriate rate credited to this account during the last year plus the net taxable income from other sources for the current year are then added to the cumulated taxable income as of the previous year to get the cumulated taxable income for the period to date. The total tax due on this total income for the period is then obtained from a tax table appropriate to the number of years covered by the period, in exactly the same way as a tax is now computed for a single year. The tax currently due is the amount necessary to bring the balance in the tax guarantee account, including accrued interest, up to the level of this total tax due.

The actual computations required of the taxpayer in a typical case can be set out as follows for a taxpayer's 1974 return with an averaging period beginning with 1970, for example:

(1) Taxable income, 1974		$15,105
(2) Cumulated tax through 1973 (copied from item (6) of 1973 return)	$12,100	
(3) Interest on (2) at 7%	847	847
(4) Cumulated income through 1973 (copied from item (5) of 1973 return)		50,010
(5) Cumulated income through 1974 (sum of items (1), (3), and (4))		$65,952
(6) Cumulated tax through 1974 on (5) (computed from tax table for 1970-1975)	15,345	
(7) Balance of Tax Due (item (6) less items (2) and (3))	2,367	

TAX TABLE FOR THE PERIOD 1970-1975

If the cumulative income for the period is . . . , the tax is

. . . .	. . . .
Over $60,000 but not over $80,000	$13,500 plus 31% of the excess over $60,000
Over $80,000 but not over $100,000	$19,600 plus 33% of the excess over $80,000
. . . .	. . . .

Two dollar amounts, the cumulative tax and the cumulative income, are carried forward from the return for the preceding year, as is the year in which the averaging began. An interest rate is applied to the cumulative tax balance, and this interest plus the current taxable net income are added to the previous cumulative income to get the new cumulative income. The table appropriate to the year in which averaging began is then entered with this cumulative income to get the cumulative tax, in exactly the same manner as the tax table for a single year is now used, the only difference being that the income and tax figures in a table covering five years will be roughly five times as large as the income and tax figures for a single year, for the bracket covered by a given tax rate. From the cumulative tax thus obtained the previous tax balance and the accrued interest for the year are subtracted to get the tax due.

As compared with a straightforward annual tax computation, this requires five or six additional lines on the return. The extra computations amount to copying two dollar amounts and a year, multiplying by an interest rate, two additions and one subtraction. By way of contrast, the averaging scheme proposed in the 1969 Canadian proposals for tax reform[3] would require carrying forward four income items from four separate returns, four additions (one of five items), two substractions, two table references (rather than one), three one-digit divisions, and one multiplication by five. To be sure, such computations would only be carried out in full and be effective in determining tax in a relatively small number of cases, but for every case where the complete calculation is made and the tax based on it, there would be several where a partial calculation is made just to see whether there is an advantage to be gained from the use of the provision, and even so the taxpayer may be in somewhat of a quandary as to whether to take immediate advantage of the provisions or wait until a possibly more advantageous moment in the future. The Ministry of Finance suggests that the computations might be performed automatically on behalf of the taxpayer by a computer, but if this can be done with that formula, which requires four amounts to be brought forward from preceding years, it would seem that the cumulative averaging computations could also be performed by a computer, and more easily, given that less information would need to be carried forward from prior records. The computations required by the averaging provisions of the current United States law are even more complicated.

In the original presentation of cumulative averaging it was suggested that the procedure be specifically an averaging one in that the tables from which the tax is computed would be such that a taxpayer who happened to have a steady income of a constant amount each year would pay the same tax whether he figured his tax on an annual basis or used the cumulative method. While this has much to recommend it as a simple and unique standard, it is not necessary that this standard be adhered to in order that the essential quality of the cumulative method be retained, namely the independence of the tax burden relative to changes in the timing of income. Since for one reason or another taxpayers will differ in the length of the periods over which they will be allowed to average, whether from death, migration, marriage, or other fundamental change in status, strict adherence to a constant income, or even,

[3] CANADIAN MINISTRY OF FINANCE, PROPOSALS FOR TAX REFORM 22-24, 34-35 (1969).

as has been suggested, an income varying in proportion to the mean per capita income of the country, might well have a tendency to penalize those with short averaging periods relative to those eligible for longer averaging periods. This would not only lead to complaints from those thus disadvantaged, but would have a deterrent influence over those actions subject to the control of the taxpayer that would have the effect of terminating the averaging period, such as marriage or separation. Appropriate adjustment of the tax tables can reduce these effects to a hardly noticeable level, without any increase in the complexity of the scheme in terms of the actual computations required of the taxpayer.

This could be done, for example, by computing the tax tables on the basis of incomes that increase or decrease over time (or both) at rates representing typical or median degrees of fluctuation of income. For a taxpayer with a typical degree of fluctuation in his income over the years, it will then make little difference to his over-all income tax burden whether his averaging periods are few and long or many and short. It will still be slightly to the advantage of a taxpayer with an unusually severely fluctuating income to avoid breaking off his averaging period, and slightly to the advantage of a taxpayer with an unusually steady income to arrange to have several shorter averaging periods. Such differentials would be relatively small, however, and in most cases it would be too difficult for a taxpayer to predict his income over long periods in the future with enough certainty to warrant his attempting to alter the normal course of events for tax reasons.

It does seem somewhat ironic that one of the main objections raised to the adoption of cumulative assessment has been the allegation that it is too complicated. This may in part have been due to the manner in which it was originally presented, and to its association with other novel or complex methods of taxation such as the proposal for a successions tax based on the transfer of "bequeathing power."[4] Actually, cumulative assessment, when coupled with full taxation of capital gains, would prove a master stroke of simplification. Taxpayers could be freed from nearly all constraints on their bookkeeping; all that would be required would be for all transactions to be entered in some form, and that omissions and double counting be eschewed. All receipts would be applied either to increase gross income or to reduce the basis of capital, the choice being at the pleasure of the taxpayer, exception being allowed only to strictly limited classes of receipts deemed to be exempt, such as gifts and bequests, and (but hopefully not for long) tax exempt interest. All outlays not construable as personal consumption outlays or noncharitable gifts may similarly be applied either as deductions from gross income or as increases in the basis of capital assets, likewise at the complete discretion of the taxpayer. The only ultimate constraint would be that the taxpayer not be allowed to write his assets down to a negative or nominal net equity, allowing for any hypothecation of the assets.

[4] W. VICKREY, AGENDA FOR PROGRESSIVE TAXATION 224-73, 428-45 (1947).

It may at first seem odd that a taxpayer should be permitted to write off his investments as rapidly as he pleases, especially as this treatment can, under present law, be considered the equivalent of exempting from income tax an amount equal to the normal rate of profits on the value thus written off. Here, however, owing to the fact that the interest factor is explicitly taken into account by allowing interest to be accumulated on early tax payments, postponement of tax by early write-off amounts simply to borrowing from the government at the stipulated interest rate. Provided that the rate of interest is maintained in suitable relation to market rates of interest, the taxpayer merely borrows from the government through tax deferment rather than from private lenders; the liquidity of the taxpayer may be enhanced, but his ultimate tax burden is not reduced.

For example, if under the present law a taxpayer subject to a thirty per cent marginal rate manages to postpone $10,000 of income for one year, say by arranging a sale on January 2 instead of December 31, his tax bill for the earlier year will then be reduced by $3,000. If he invests this $3,000 for one year at say eight per cent, he will realize $3,240. He will, with respect to the second year, have to pay a tax at thirty per cent not only on the $10,000 of income postponed, but on the $240 of interest earned, or a tax of $3,072, but even so he will wind up $168 better off. Under cumulative assessment, on the other hand, paying the $3,000 tax in the earlier year increases the balance in the tax guarantee account by $3,000, and if eight per cent is used as the rate of interest credited to this account, equivalent to what could be earned on the outside, the $240 credited to this account and included in cumulated income just balances the $240 that the taxpayer could have earned by postponing tax and investing the amount himself. The cumulative income at the end of the later year is the same in either case, as is also therefore the cumulative tax. The tax payment in the second year will be $3,240 lower in the second year if the $3,000 were paid in the earlier year than if it were not, as a result of the balance in the tax guarantee account being $3,240 higher, and the taxpayer will wind up equally well off in either case. Investment in early tax payments is made just as profitable as outside investment of funds obtained by deferring taxes, for such a case.

Of course, if the taxpayer has opportunities for investment that yield a higher return than the rate of interest currently being credited on the tax guarantee account, he will be able to gain from postponing his taxes. But this gain is essentially no different from the gain he could realize by borrowing from any other source at the given rate of interest. The only effect of cumulative averaging is to offer a new source of borrowed funds, which may provide an improvement in the liquidity position of the taxpayer. To the extent that this takes place, it may well be considered a desirable improvement in the efficiency of the over-all capital market. However, the enhancement of liquidity provided by cumulative averaging is likely to prove considerably less substantial than might appear on the surface; a taxpayer who shows a potential lender a ledger with assets written down for tax purposes may expect his line of credit to be somewhat shorter than if his books showed the full value. Even if the lender is fully aware of the market values and is prepared to rely on them, he will have to take into consideration the potential liability for the deferred taxes. Therefore, borrowing by tax deferral may, to a considerable extent, be at the expense of ability to borrow from other sources.

The main reason for limiting the write-down of assets for tax purposes would be the avoidance of a situation where the government would find itself unable to collect the tax ultimately due on the liquidation of the assets. For the bulk of responsible taxpayers this should not present any problem; any realization in excess of book value would itself provide the funds for the payment of the tax on the capital gain thus revealed. Unless a taxpayer has actually concealed his assets and liabilities, even bankruptcy would represent no problem. A taxpayer with no net worth would have no tax due beyond what he presumably has already paid with respect to income realized and spent on personal consumption. The chief remaining danger would be that the taxpayer might, having written down his assets to a nominal figure, suddenly exchange them for cash or foreign assets and abscond from the jurisdiction. Presumably the appropriate way to deal with this would be through the use of the jeopardy assessment procedures of Chapter 70 of the Internal Revenue Code. While unlimited early write-off might increase the gain to the taxpayer from such absconding, and thus possibly increase the risk of revenue loss, the unusually heavy use by the taxpayer of such a write-off might in turn serve as a flag to alert revenue agents of the possibility of such absconding.

Although cumulative averaging was originally thought of as simply an elegant and precise way of achieving the equity which is the main *raison d'être* of most averaging proposals, it has become increasingly clear that the principal and unique achievement offered by cumulative averaging lies in the drastic simplification of the tax law and regulations which it makes possible, in conjunction, of course, with the full taxation of capital gains on the same basis as other income. Even the most complete averaging of income, while of course making substantial differences in extreme cases, makes surprisingly little difference in the way the income tax burden is distributed in practice and while it may be considered desirable or even essential to provide exceptional relief for these exceptional cases, the magnitude of the problem relative to the over-all yield of the tax may seem too small to warrant going to a reform as far-reaching as cumulative assessment. When, however, cumulative assessment is looked at as a means of simplifying the law and drastically reducing if not eliminating altogether the impact of technical tax considerations on the conduct of business and economic activity of all kinds, the minor complexities of cumulative averaging become a minute price to pay, and the adoption of cumulative averaging, far from being an added complication, emerges as a master stroke of simplification.

It is, indeed, instructive to go systematically through the Internal Revenue Code to see what sections could be deleted with the introduction of such a cumulative

TABLE 1

PROVISIONS OF THE INTERNAL REVENUE CODE AND REGULATIONS THAT COULD BE DELETED WITH CUMULATIVE ASSESSMENT

Section	Subject	Approximate Number of Pages		
		1954 Code[5]	Code as Amended to 1970[6]	Regulations as of August 1969[7]
77	Commodity Credit Loans	0.2	0.3	xx
79	Group Term Insurance	xx	1.0	7.5
80	Securities Previously Written Off	xx	0.8	xx
81	Suspense Accounts	xx	0.3	xx
83	Property Transferred in Conjunction with Services	xx	2.5	xx
108	Discharge of Indebtedness	0.8	1.0	2.3
109	Improvements to Property by Lessee	0.1	0.1	0.5
111	Recovery of Bad Debts, etc.	1.0	1.0	2.8
121	Sale of Residence by Taxpayer over 65	xx	1.7	4.0
167	Depreciation	1.5	8.0	26.5
168	Amortization of Emergency Facilities	2.6	4.3	6.0
169	Amortization of Grain Storage/Pollution Control	2.5	2.5	7.7
171	Amortization of Bond Premiums	2.0	2.0	5.2
172	Net Operating Loss Carryback, Carryover	2.7	10.0	25.0
173	Circulation Promotion Expenses	0.4	0.3	0.9
174	Expenditures for Research and Experimentation	1.3	1.3	5.5
175	Soil and Water Conservation Expenditures	1.2	2.0	3.5
177	Trademark and Copyright Expenditures	xx	0.8	1.5
178	Amortization of Improvements by Lessee	xx	1.1	4.9
179	Additional First Year Depreciation	xx	1.8	6.1
180	Fertilizer Expenditures	xx	0.6	0.7
182	Land Clearing Expenditures	xx	1.2	3.9
184	Amortization of Rolling Stock	xx	2.2	xx
185	Amortization of Grading and Tunnel Bores	xx	1.2	xx
187	Coal Mine Safety Equipment	xx	1.2	xx
248	Amortization of Organizational Expenses	0.5	0.5	1.1
263	Non-deductibility of Capital Expenditures	0.6	1.4	xx
264	Life Insurance Premiums on Employees Lives	0.4	1.0	4.4
266	Capitalization of Taxes and Carrying Charges	0.1	0.2	2.0
268	Sale of Land with Unharvested Crop	0.2	0.2	0.2
272	Disposal of Coal Property	0.2	0.4	1.5
273	Non-amortization of Testamentary Annuities	0.2	0.2	xx
278	Development Expenses of Citrus Groves	xx	0.4	xx
281	Income of Terminal Railroads	xx	2.2	xx
301–07	Distributions to Shareholders	11.0	14.0	21.5
331–95	Stockholders Treatment in Liquidation and Reorganization	31.7	44.1	162.0
401–25	Deferred Compensation	13.2	42.5	150.0
441–83	Accounting Methods	13.4	31.0	160.0
531–37	Improper Accumulation of Surplus	3.3	6.0	8.5
541–47	Personal Holding Companies	10.8	21.0	26.0
611–17	Depletion	7.1	24.0	90.0
1001–91	Gain and Loss	24.7	31.8	108.0
1201–45	Capital Gain and Loss	13.2	54.0	76.0
	Total	146.1	322.2	942.0

Sources:

[5] CCH INT. REV. CODE OF 1954 (1954).

[6] CCH INCOME, ESTATE, AND GIFT TAX PROVISIONS, INTERNAL REVENUE CODE—INCLUDING 1969 AMENDMENTS (1970).

[7] CCH INCOME TAX REGS. AS OF AUG. 1, 1969 (1969).

TABLE 2

PROVISIONS OF THE INTERNAL REVENUE CODE AND REGULATIONS THAT COULD BE SUBSTANTIALLY SHORTENED WITH CUMULATIVE ASSESSMENT

		Approximate Number of Pages		
Section	Subject	1954 Code	Code as Amended to 1970	Regulations As of August 1969
37	Retirement Income	1.3	3.0	7.8
56	Tax Preference Tax	xx	8.5	xx
72	Annuities	4.0	9.0	72.0
101	Death Benefits	2.2	3.0	17.5
104–05	Accident Compensation and Insurance	1.5	2.2	17.0
122	Reduced Retirement Pay Options	xx	0.5	xx
165	Losses	1.2	3.0	13.0
166	Bad Debts	1.0	2.5	5.7
170	Charitable Contributions (in Property)	0.3	6.9	26.7
		11.3	38.6	159.7
Subchapter				
JJ	Estates and Trusts	24.0	32.0	106.0
K	Partnerships	15.3	17.0	58.0
L	Insurance	12.5	67.0	158.0
M	Investment Trusts	6.7	15.0	29.0
Q	Miscellaneous Adjustments Between Years	15.5	12.1	40.0
R	Taxation of Partnerships as Corporations	xx	4.5	13.0
		58.5	135.5	314.0
		69.8	174.1	473.7

Sources: Same as Table 1.

assessment basis. A somewhat hastily compiled list appears in Table 1. In addition to the sections listed in Table 1 that could be almost totally eliminated, there are a number of other sections which would be drastically shortened or simplified if the appropriate changes were made to accommodate cumulative assessment. Table 2 lists the more salient cases of this sort. As the entire Chapter I of the Internal Revenue Code of 1954 runs to 355 pages, it will be seen that cumulative assessment, even if it only eliminates half of the 69.8 pages in the second category, results in cutting the code in half, even allowing for fairly substantial amounts of new material necessary to fully implement cumulative assessment.

In many cases, to be sure, it may be too much to expect that the specific provisions would be immediately removed from the statute books. Even if the complicated provisions are not repealed outright, however, cumulative assessment would in most cases leave both the taxpayer and the Internal Revenue Service with little incentive to dispute questionable points, and even more important, would enable the taxpayers to make decisions without having to consider the tax consequences (except, of course, to the extent that their effects on the liquidity of the taxpayer might be important, rather than their long run effects).

In some cases, as with the depletion provisions, their repeal would represent a removal of a discrimination which, however much it may have been deplored by tax analysts, has mustered strong support from the allies of those standing to benefit. Cumulative averaging would allow most of these special deductions to be continued, at least for those for whom the deduction would not involve a reduction of basis to below zero, while at the same time bringing closer the possibility that the inequity inherent in these deductions as they operate at present could be eliminated by ultimately bringing net returns in excess of outlays into account for income tax purposes. It would be ironic, for example, to permit ordinary investors to write off their investments at whatever rate they please but to deny this privilege to oil investors, while on the other hand it would be somewhat more obviously inequitable to allow specifically for depletable resources to be written down to a negative value without any defined limit. Cumulative assessment is thus not only an important reform in its own right, but also facilitates other reforms. It is, indeed, an essential keystone of any thoroughgoing reform of the income tax structure, without which the structure remains a patchwork congeries of incompletely integrated provisions.

If cumulative assessment can do so much for so little, one may well ask why has it not been universally acclaimed and adopted in the thirty years since it was first proposed? Inertia is obviously a large part of the answer, but not all. Part of the answer is a failure on the part of its proponents to realize the salient importance of the simplification aspects of the proposal as distinguished from its equity aspects. But much of the neglect stems from the persistent notion that cumulative assessment is complicated. Administrative complexity was indeed cited as one of the reasons for rejecting the scheme by the Canadian Royal Commission on Taxation in 1966.[5] Yet the Commission eventually recommended an averaging provision that is much more complicated than cumulative assessment in terms of the volume of records required to be maintained and the number of computations required, and which largely fails to provide the potential for simplification in other directions that cumulative assessment offers.

It must be admitted that there are complications involved in cumulative assessment that relate to changes in marital or jurisdictional status of the taxpayer, complications that are particularly important in Canada where the number of taxpayers changing their residence from Canada to the United States or other foreign countries or vice versa relative to the total number of domestic taxpayers is larger than in the United States and most other countries relying heavily on the income tax. Canada would, for this reason, be in a relatively poor position to be the first to experiment with this innovation. Yet even so, the problems would seem to be surmountable with difficulties that would be minor relative to the advantages to be gained.

The problem of change in marital status, which is a more nearly universal problem, can be resolved in a number of ways, none of which are entirely without draw-

[5] 3 REPORT OF THE ROYAL COMMISSION ON TAXATION 257, 281 (1966).

backs, but among which should be found one or two reasonably satisfactory ones. The straightforward procedure, that of determining a separate income for each individual from, say, his majority through death, without interruptions for change of marital status, would involve detailed accounting for transactions between husband and wife, including, in principle, separation of imputed income from the use of consumer durables. Even were this feasible, this seems an unattractive alternative. Another possibility is to break the averaging period at time of change of marital status, involving a valuation of assets and a bringing to account of all unrealized capital gains at that time. This need not involve a heavy tax liability at that point; provision could be made for offsetting the gains thus brought to account for the period preceding the change in status against the writing down of assets in the accounts for the initial period subsequent to the change of status. Nor would there necessarily be any penalty attached to the interruption of the averaging period other than the additional reporting and calculation required. As indicated above, the tax tables may be drawn up so as to produce equality, on the average, between taxpayers with short and with long averaging periods. A third and perhaps the most satisfactory alternative is to carry the averaging period for each individual through changes in marital status with splitting of income accrued during marriage. This likewise would require a valuation of assets at the time of change of status, to prevent nominal accounting changes or transaction formalities from producing shifts of income from one partner to the other, but again in most cases the amount at stake in these valuations in terms of long run over-all tax burden would tend to be relatively small and the ultimate direction of the net effect frequently uncertain, so that pressures to distort this valuation in one direction or the other for tax reasons would be minimal. The important valuation for determining over-all ultimate tax burdens would be the final valuation at death, but in this case the valuation must be made fairly carefully for estate and death duties in any event.

Dealing with changes in residence or citizenship status is a somewhat more difficult problem. Once-in-a-lifetime changes can of course be appropriately dealt with by terminating the averaging period with a valuation of assets and assessment of accrued gains and losses. While this will mean that fairly substantial tax differentials may in some cases hinge on the timing of the change in status, it is in this case somewhat doubtful whether one would want to preserve tax neutrality towards changes of residence or citizenship even if that could be done. Tours of duty abroad and similar situations will require somewhat more complicated procedures to work out an equitable formula, presumably on the basis of retaining fully in the tax base all unearned income and making some adjustment for earnings, expenditures, and taxes abroad. The corresponding provisions in existing laws are at least as arbitrary and no less complex in their application. Indeed, even though cumulative assessement may be conceptually rather complex under these circumstances, it seems likely that here too the actual application of the rules can be made basically simpler and less discriminatory than the existing provisions. In any case it would be virtually hopeless for any one jurisdiction to attempt to preserve tax neutrality in such cases independently of what other jurisdictions might do. Thus even here the charge of complexity seems on examination to be without real substance. Novelty, yes, and abstruseness of concept, possibly, but practical complexity, no.

Another element in the resistance to cumulative assessment as a solution for the manifold ailments of the income tax is a somewhat loosely articulated philosophical feeling that a lifetime of income is too much to consider as a unit for tax assessment, and that even periods of fifteen or thirty years would be really too long.[6] There may be, indeed, a sense in which a man in his fifties is a different person from the same man in his twenties, but it is not at all clear whether this would argue for a lesser or for a greater concession with respect to fluctuations in income than would be granted by long-term averaging. Arguments based on maximizing aggregate utility might argue in one direction and those based on concepts of equity, fairness, or egalitarianism might argue in the other.

Consider, for example, a comparison between *C* who because of family connections or otherwise steps into a $30,000 job immediately after graduation, and holds that constant level throughout his career, and *G* who starts off at say $10,000 and by dint of application and energy gradually rises through the ranks to a top of $50,000 near the end of his career, both having the same "lifetime" income. In terms of because of his inability to borrow against his future earnings he has to skimp on his standard of living in his early years in a way that he considers less satisfactory than that which he would have chosen had he been free to borrow and reallocate his expenditure. To impose a higher tax burden on him would seem to be adding insult to injury. Yet a utilitarian, arguing on the basis of maximizing aggregate utility, could claim that the heavier taxation of *G* in the later years would cut into a relatively more frivolous and luxurious level of consumption than would additional taxation of *C*, and that, therefore, the heavier rate on *G*'s later income than on *C*'s income would be needed to maximize total utility, consumption patterns in previous years being "bygones." Even this argument, however, would hardly justify levying as high a rate on *G*'s later years as would be levied on the income of an individual *W* whose income has been steadily at the $50,000 level, given that *W* will probably have a considerably higher level of accumulated consumer durables to enjoy than would *G*. Moreover *G*, in the process of adapting his life-style to his progressively increasing resources, will probably have been to some considerable additional expense in disposing of his early less luxurious items and acquiring progressively better ones, and in moving from more modest to more sumptuous quarters, so that for this reason too his current status is substantially inferior to that of *W*, even if one considers him to be in effect an entirely new person with no recollection of his

[6] "[W]e could see no justification for using a lifetime, or the lengthy periods described above, as the interval over which income shoud be averaged." *Id.* at 257.

previous incarnation. Yet most averaging provisions as currently applied will give no relief whatever to *G* relative to *W*, and even if a five- or ten-year averaging scheme were applied entirely without the threshold provisions that typically deny application of averaging except in cases of large excesses of current income over an average of the incomes of the recent past, the benefit of such averaging would be minute.

Other appealing cases are those of the writer of a best-seller, and of the athletic star, where a period of very high earning power is followed by much more modest levels of income. In such cases, where the individual not only anticipates the later lower levels of income but himself provides for this period by saving relatively large amounts out of his high earnings period, the utilitarian rationale for higher taxation does not apply, and it is particularly hard to defend the "separate incarnation" concept when the younger self is observed to provide specifically for the older self.

The "separate incarnation" theory seems particularly weak when it is used to defend the status quo in that the current tax law contains many provisions that result in current tax liability depending on transactions which may have taken place many decades previously, indeed in some cases before the birth of the taxpayer, as when he is asked to pay a capital gains tax on property handed down by gift over several generations. To be sure, some of these long-term effects are incidental effects of provisions enacted without concern as to the time-span over which they would operate, as with the capital gains provisions involved in the above case. But in other cases the time-span is quite deliberate, as with the provisions relating to pension plans and deferred compensation generally. And it is indeed ludicrous to see the rather pusillanimous provisions of sections 1301 and 1302 regarding lump-sum payments of income in relation to efforts spanning several years being altogether ignored in favor of the far juicier possibilities involved in the conversion of such income into "capital gains" by various contractual antics. At best, indeed, the "separate incarnation" concept is hard to square with current tax provisions, and it would be hard to justify on such a basis the restriction of averaging to as short a period as five years, as seems to be the general practice at present. And if one were to attempt to meet this objection to the five year period head-on by allowing ten or fifteen years, the added administrative and computational burden would make the comparative simplicity of cumulative assessment seem even more attractive.

Still another apprehension with respect to universal averaging in general, the contagion of which has spread unwarrantedly to cumulative averaging, is that it might interfere in some way with fiscal policy. Ordinary averaging devices indeed often introduce a time lag element in the relation between income and tax payments, reducing the "built-in flexibility" of the tax by damping somewhat the tendency of the tax yield to increase during boom years more than in proportion to the increase in incomes. In the case of some of the compulsory schemes, there is even a tendency to produce larger tax payments in lean years than would be payable on a straight annual basis. Cumulative averaging, however, counters this lag with a fairly strong enhancement of countercyclical effects on the downswing, when tax abatement and even refunds will tend to occur as income is in effect brought forward from brackets previously taxed at high rates and the tax previously paid on this income is credited against a new tax computed at lower bracket rates. Moreover, by eliminating the inequities now associated with the sudden changes in annual rates that would often be called for to implement fully a strong fiscal policy, as some taxpayers are caught with high income realization in high rate years while others are fortunate or perspicacious enough to have more of their income fall in the relatively low rate years, cumulative averaging removes a significant deterrent to vigorous fiscal policy. Cumulative averaging also adds a new instrument of macroeconomic policy in the possibility of changing the interest rate which will be applied in bringing forward the cumulative present value of past tax payments. Far from interfering with fiscal policy, cumulative averaging facilitates and enhances it.

Yet in spite of the weakness of these more respectable arguments against the adoption of cumulative assessment, the practical obstacles to its adoption remain formidable, at least in the United States. In a subtle way, cumulative averaging represents a threat to powerfully entrenched forces. To many legislators, power to trade and manipulate the intricate clauses by which favors are granted to or withheld from special groups is one of the essentials of political maneuvering that would be severely constrained by tax simplification. To lawyers and accountants who are especially influential in the drafting of legislation, their knowledge of the intricacy of the law is an investment that they would be reluctant to see become obsolete by major simplification, and the drafting of new intricacies is the perverse expression of the exercise of a skill in which they take considerable pride, though this pride is increasingly tinged with apprehension at the seemingly uncontrollable growth of the Frankenstein's monster they have nurtured. And to the many groups of taxpayers that benefit from one special provision or another, simplification threatens their privileged position. Even were one to offer a reduction in the top bracket rates as an offset to the elimination of these various loopholes, and even if this could be done in such a way that few if any would be worse off as a result of the bargain, many loophole users might well hesitate to accept the bargain, preferring the known evil of high rates tempered by long-established loopholes to the possibility that once having lost their loophole in a trade for lower rates, a subsequent legislature, not being bound to the terms of the bargain, might again raise the rates.

Yet even in face of these rather formidable obstacles, it seems possible that if the average business man were clearly presented with the prospect of a tax under which he would be able to keep his accounts in any consistent way he sees fit, and to shape his transactions in any way that suits his business purposes without having to consider tax consequences at every turn, and without having to fear that a competitor will be able to take unfair advantage because of the tax law, or that his company will be raided for the sake of special tax positions, a fair amount of support for fundamental tax reform could be generated. Without cumulative assessment, the prospects for generating such support will be slight, and the experience with the 1969 tax reforms suggests that piecemeal attempts at reform or simplification, however well intentioned, may be converted by the legislative processes and the operations of the conference committee into new and more baffling intricacies.[7] Cumulative assessment seems indeed the essential key to effective simplification.

[7] *See* Tax Reform Act of 1969, Pub. L. No. 91-172 (Dec. 30, 1969).