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FOREWORD

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It is no secret that there has been an explosion of federal tax legislation in recent years. Since President Reagan's inauguration in 1981, there have been three major tax acts: the Economic Recovery Tax Act of 1981 (ERTA),[1] the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA),[2] and the Tax Reform Act of 1984 (enacted as part of the Deficit Reduction Act of 1984—DEFRA).[3] In addition to these three Acts, which have had broad applicability, there have been a number of specialized bills of narrow applicability, but of considerable significance to the taxpayers affected. The most prominent among these are the Subchapter S Revision Act of 1982,[4] the Social Security Amendments of 1983,[5] and the Technical Corrections Act of 1982.[6]

To put this activity in perspective, it is instructive to note that major revisions to the 1954 Internal Revenue Code (the "Code") have until recently been infrequent. Any list of "major" enactments is unavoidably subjective, but I would cite the following as a more or less complete list of enactments having a broad impact on the Code:[7] the Revenue Act of 1962;[8] the Revenue Act of 1964;[9] the Tax Reform Act of 1969;[10] the Tax Reform Act of 1976;[11]

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1. Pub. L. No. 97-34, 95 Stat. 172.
2. Pub. L. No. 97-248, 96 Stat. 324.
3. Pub. L. No. 98-369, 98 Stat. 494.
4. Pub. L. No. 97-354, 96 Stat. 1669.
5. Pub. L. No. 98-21, 97 Stat. 65.
6. Pub. L. No. 97-448, 96 Stat. 2365.
7. Among those acts which did not have a broad impact on the tax code but which were nevertheless of significant importance to affected taxpayers were the Life Insurance Company Income Tax Act of 1959, Pub. L. No. 86-69, 73 Stat. 112, the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829, the Crude Oil Windfall Profits Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229, and the Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, 94 Stat. 3389.
8. Pub. L. No. 87-834, 76 Stat. 960.
9. Pub. L. No. 88-272, 78 Stat. 19.
10. Pub. L. No. 91-172, 83 Stat. 487.
11. Pub. L. No. 94-455, 90 Stat. 1520.

and (perhaps) the Revenue Act of 1978.[12] At the risk of suggesting excessive attention to the executive branch's role in tax legislation,[13] it may be noted that this list of tax acts produces exactly one major enactment during the terms of each of the five presidents immediately preceding President Reagan.[14] How does it happen, then, that there have been three major acts in the first term of President Reagan's Administration, and that, as we go to press, a fourth major proposal[15] is in process?

To some degree, the volume and scope of the legislative activity surely reflect the new political order: the simultaneous election in 1980 of the most conservative president in generations and the first Republican majority in either house of Congress in nearly thirty years.[16] This political reorientation is the subject of Professor Charles Jacob's article,[17] which argues that the political changes resulting from the 1980 election and its aftermath were "revolutionary."[18] Whether or not one agrees with the characterization, one cannot doubt the significance of the political climate in assessing the tax changes of recent years, especially in ERTA, as Professor Jacob ably demonstrates.

The level of activity also seems to reflect a fairly deep dissatisfaction with the pre-1981 tax system. This dissatisfaction has proven remarkably resistant to any amelioration resulting from the legislation it has provoked. As the Treasury Department itself has recently noted, the U.S. income tax is still perceived by taxpayers to be unfair, as well as being complex and inefficient.[19]

One explanation for the failure of the legislation of recent years to relieve any substantial part of the taxpayer's unhappiness with the tax system is that the dissatisfaction has not been translated into any congressional reluctance to use the Code to achieve a wide variety of social and economic goals.

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12. Pub. L. No. 95-600, 92 Stat. 2763.

13. I am using presidential terms of office here as a means of describing demi-epochs, not to attribute each piece of tax legislation to the particular president who happened to sign the enrolled bill. Not only are many tax bills principally congressional in origin, but others that are enacted in one president's term may have been largely designed by his predecessor. For example, the so-called Kennedy tax act was introduced by President Kennedy in 1963, but enacted as the Revenue Act of 1964, Pub. L. No. 88-272, 78 Stat. 19 during Lyndon Johnson's Presidency.

14. Although some of the presidents referred to served less than one full term in office (viz., Kennedy and Ford), the five presidents immediately preceding President Reagan did serve five full terms altogether, from 1961 to 1981.

15. THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY (1985) [hereinafter cited as PRES. PROPOSALS].

16. In the 83rd Congress (1953-55), there was a Republican majority in the House of Representatives of 221 Republicans and 210 Democrats, and a Republican plurality in the Senate of 48 Republicans, 47 Democrats and one independent. OFFICIAL CONGRESSIONAL DIRECTORY, 83d Cong., 1st Sess. 171 (1953). Interestingly, it was this Congress that enacted the 1954 Internal Revenue Code.

17. Jacob, *Reaganomics: The Revolution in American Political Economy*, LAW & CONTEMP. PROBS., Autumn 1985, at 7.

18. *Id.*

19. 1 U.S. DEP'T OF THE TREASURY, REPORT TO THE PRESIDENT: TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH iii (1984) (Regan, Transmittal Letter of Treasury Department's Report on Fundamental Tax Simplification and Reform to President Reagan) (in three volumes, Vol. 1, Overview; Vol. 2, General Explanation of the Treasury Proposals; and Vol. 3, Value-Added Tax) [hereinafter cited as TREAS. REPORT].

ERTA, in particular, is rife with examples of congressional efforts to further nontax objectives by tinkering with the Code. Two of these examples—the effort to stimulate capital formation generally, and the effort to stimulate rehabilitation of certified historic structures—are subjects of examination in this issue.[20] Congress has persistently refused to heed the warning that the late Stanley Surrey issued nearly twenty years ago: that the conceptual soundness of—and the high level of voluntary compliance with—the tax law could not be taken for granted, and that too much use of the Code for nontax purposes would ultimately enervate our tax system.[21]

Rather than avoiding use of the Code for nontax purposes, Congress has tried to control, even fine-tune, those uses. The efforts at control have been necessary to avoid egregious abuse; without such efforts, the revenue erosion due to tax incentives might by now be approaching disastrous proportions. The controls have come with their own costs, however. They have contributed greatly to the outrageous complexity of the present Code. An excellent case history illustrating this dynamic is contained in a student note's description of the emerging restrictions on the use of industrial development bonds.[22] While ultimately successful at limiting what threatened to become an intolerable revenue drain, the recent revisions in this area have accomplished this result only by adding layer after layer of rules, exceptions, and exceptions to exceptions.[23] A second student note, which addresses the tax treatment of annuities,[24] provides another clear example of the complexity of recent statutory responses to perceived abuses.

The tax system might better tolerate the many skirmishes along its peripheries—industrial development bonds, certified historic structure rehabilitation, and the like—if its core structure were solid. Increasingly, however, the integrity of the conceptual core itself has been called into question by the continuing inability of the tax system to deal with fundamental problems. Problems at the core of the system are addressed directly by three contributors: Professor Charles Galvin explores the increasing tendency of the system toward an unsatisfactory hybrid of accretion and consumption features;[25] Willard Taylor discusses the persistent difficulties of dealing with the two-tiered system of taxing income earned by

20. Gann, *Neutral Taxation of Capital Income: An Achievable Goal?*, LAW & CONTEMP. PROBS., Autumn 1985, at 77; Note, *The Impact of ERTA and TEFRA on Tax Credits for Historic Preservation*, LAW & CONTEMP. PROBS., Autumn 1985, at 259.

21. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352, 359 (1970); Surrey, *Tax Incentives as a Device for Implementing Governmental Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 731-34 (1970).

22. Note, *Bedtime for [Industrial Development] Bonds?: Municipal Bond Tax Legislation of the First Reagan Administration*, LAW & CONTEMP. PROBS., Autumn 1985, at 213.

23. *Id.* at 251.

24. Note, *TEFRA's Response to Short-Term Abuses of Insurance Annuity Policies*, LAW & CONTEMP. PROBS., Autumn 1985, at 281.

25. Galvin, *Tax Legislation in the Reagan Era—Movement to or from a Consumption Base?*, LAW & CONTEMP. PROBS., Autumn 1985, at 31.

corporations;[26] and Professor Pamela Gann examines the tax system's inability to treat income from capital in a neutral manner.[27]

What is the outlook for future developments? As this issue goes to press, the President's tax proposals[28] are much in the public mind. In this issue, Professor Gordon Bale reflects on some aspects of those proposals from a Canadian perspective.[29] In addition, several authors have alluded to the proposals (or to the Treasury Report[30] on which the President's proposals are based) in the course of their otherwise retrospective discussions of past tax legislation.[31]

The central thrust of the President's proposals is to lower significantly marginal rates of tax,[32] while broadening the tax base sufficiently to allow the same total revenue to be raised as would be raised under a continuation of the present structure.[33] Although lower rates have obvious appeal, it is becoming clear that even so apparently attractive a proposal as lowering rates has its adversaries. High rates are to tax incentives what a stiff breeze is to a sailboat—that which provides both power and maneuverability. Congressional acts in recent years suggest that Congress has not lost its taste for using the Code to manipulate market behavior. These acts make one wonder whether the Congress really wants a Code under which low marginal rates make tax considerations relatively unimportant.

The base-broadening aspects of the President's proposals add a second tier of disturbance to those industries or sectors at whose expense the base is broadened: not only would lower rates make a constant incentive less valuable, but the incentives themselves would be pruned. This problem is faced by a number of sectors of the economy whose tax-protected status has in past years been found by Congress to be well deserved. The charitable sector is a prime example, and Professor Charles Clotfelter's projections in this issue[34] of the impact of various current tax proposals on the levels of voluntary support provided to charitable organizations in various categories give the reader a strong sense of how difficult it will be to achieve real tax reform without substantial dislocations.

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26. Taylor, *Tax Policy and Changes to Subchapter C,* LAW & CONTEMP. PROBS., Autumn 1985, at 57.

27. Gann, *supra* note 20.

28. PRES. PROPOSALS, *supra* note 15.

29. Bale, *The Treasury's Proposals for Tax Reform: A Canadian Perspective,* LAW & CONTEMP. PROBS., Autumn 1985, at 151.

30. TREAS. REPORT, *supra* note 19.

31. Clotfelter, *Charitable Giving and Tax Legislation in the Reagan Era,* LAW & CONTEMP. PROBS., Autumn 1985, at 197; Gann, *supra* note 20; Taylor, *supra* note 26.

32. On incomes above the tax threshold ($12,000 for a familiy of four), up to three different rates—15%, 25%, and 35%—will apply sequentially. PRES. PROPOSALS, *supra* note 15, at 10.

33. Projected revenue receipts under the proposals deviate by 0.5 to 10.3 billion dollars from the current receipts for each fiscal year in fiscal years 1986-90, out of a total of 503 to 703 billion dollars. *Id.* at 45, Table 4.2.

34. Clotfelter, *supra* note 31.

Despite these difficulties, there does seem to be strong support for the President's proposals among the contributors to this issue.[35] The proposals would clearly operate to strengthen the core of our income tax system at a time when that is badly needed. And the fact that the system would be less hospitable to incentives can only be viewed as an advantage.

If deep reform is achieved in the near future—if there is a Tax Perfection Act of 1985 or 1986—will it accomplish the goals of improving fairness, simplicity, and economic growth?[36] My own view is that much can be done to improve the fairness of the income tax system. I also believe a fair tax system is a neutral one, and that the tax system can best contribute to a healthy economy by achieving some reasonable level of neutrality, thereby minimizing market distortion. Fairness and economic growth, then, seem entirely compatible goals.[37]

Fairness and simplicity are widely perceived to be compatible goals as well. Indeed, President Reagan himself expressed the view in his 1984 State of the Union address that simplicity actually *produces* fairness.[38] In many situations, however, almost the opposite seems to be the case. In areas like depreciation accounting, for example, simple systems are likely to be crude systems—ones which are too generous to some taxpayers, and too niggardly toward others. Some degree of refinement of the rules is essential if we are to produce results that are satisfactory in terms of fairness and in terms of the tax neutrality upon which a healthy economy depends.

That is not to say, of course, that there are not rules in the Code that reflect excessive refinement. Complete consensus on which rules those are would be difficult to achieve, but any tax practitioner could think of dozens of rules that could be greatly simplified without significant loss of legislative purpose. The question always seems to be whether the cost in terms of

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35. A symposium was held at the Duke University Law School on January 11-12, 1985, in connection with the preparation of this issue. A substantial part of the January 12 session was devoted to open and generally approbatory discussion of the Treasury proposals (most of which were incorporated into the President's Proposals in May), led by Professor S. Malcolm Gillis of the Duke University Economics Department. In addition to Professor Gillis and the other contributors to this issue, participants in the symposium included Professor James David Barber of the Duke University Political Science Department, Professors William Turnier and Patricia Bryan of the University of North Carolina School of Law, Mr. Robert A. Klayman, a partner in the Washington, D.C. law firm of Caplin & Drysdale, and Mr. Don S. Samuelson, a principal in Samuelson Associates, of Chicago, Ill. Their participation contributed greatly to this venture, and is gratefully acknowledged.

36. The very title of the President's proposal—TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY—suggests the importance of these goals to the Administration.

37. For a discussion of the tendency of taxes to distort economic choices, see R. MUSGRAVE & P. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 303-17 (3d ed. 1980).

38. The relationship of these goals in President Reagan's mind is perhaps best suggested by his own words:

> There's a better way: Let us go forward with an historic reform for fairness, simplicity, and incentives for growth. I am asking Secretary Don Regan for a plan of action to simplify the entire tax code so all taxpayers, big and small, are treated more fairly.

H.R. Doc. No. 98-162, 98th Cong., 2d Sess. (1984), 130 Cong. Rec. H145 (daily ed. Jan. 25, 1984) (State of the Union Address by the President of the United States).

simplicity of any particular rule-refining provision is exceeded by the benefit that that refinement produces in terms of accurately serving Congress' intent.

The most useful single distinction to be made in separating cost-effective complexity from that which is not would seem to be whether the particular provision primarily affects ordinary, individual taxpayers, or primarily affects business taxpayers and the highest echelons of individual taxpayers.[39] If the issue is clearly in the first category (*e.g.*, the child-care credit[40]), almost any degree of refinement is excessive.[41] If the issue is in the second category (*e.g.*, treatment of original issue discount on taxable bonds[42]), almost any degree of refinement is acceptable; and, indeed, a fairly high degree of refinement may be necessary to prevent abuse.[43]

The larger point in this is one that I hope Congress will heed: fairness and simplicity are in important respects competing goals, not complementary ones. Although laudable in intent, sweeping simplification efforts run the serious risk of leaving us with a Code that is insufficiently muscular to achieve any other desiderata of a sound tax system. What we need, in other words, is careful, sophisticated reform. Is Congress capable of producing such reform? As to the future, that naturally remains to be seen. The contents of this issue make it clear, however, that Congress has certainly not demonstrated recently that it has the capacity to make hard choices intelligently, at least in the tax area. If that continues to be true, we may have witnessed only the beginning of a long series of generally ineffective efforts to repair our tax system.

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39. This distinction, like most, is not always clear at the edges. Small business owners in particular pose special problems: the basic nature of their tax issues may be the same as the counterpart issues of large corporations, but the legal and accounting costs of complying with sophisticated rules may be very burdensome.

40. I.R.C. § 21 (Lawyer's Co-op. Supp. 1985) (formerly § 44A, recodified by DEFRA § 471(c)(1)).

41. The child care credit permits eligible taxpayers to take a tax credit for a percentage of qualified household and dependent care expenses, which percentage varies with the taxpayer's adjusted gross income, but is never more than 30% nor less than 20%. It seems very questionable whether the precise allocation of the credit within this range is sufficiently worthwhile to justify the complexity of a sliding scale.

42. I.R.C. § 1272 (Lawyer's Co-op. Supp. 1985) (added by DEFRA § 41(a)).

43. The Finance Committee explained the concern about abuse as follows:

> The OID rules were enacted in 1969 to eliminate the distortions caused by the mismatching of income and deductions . . . . 'The possibility of such mismatching still may exist in the case of obligations that come within one of the exceptions to the OID rules. Some taxpayers have attempted to exploit these exceptions.

Explanation of Provisions Approved by the Committee on Mar. 21, 1984, S. Rep. No. 98-169, at 250-51.