

FOREWORD: THE FABULOUS INVALID NEARS 100

LAWRENCE A. ZELENAK*

Now in its ninety-seventh year,¹ and under no imminent threat from a Democratic Congress and a Democratic President, the federal income tax is nearly assured of surviving until its one-hundredth birthday in 2013. It was not always so clear that the tax would reach that milestone. In public opinion polls from the late 1970s to the late 1980s, a plurality of respondents consistently identified the income tax as “the worst tax—that is, the least fair.”² In the mid-1990s the Chairman of the House Ways and Means Committee repeatedly expressed his desire to “tear the income tax out by its roots and throw it overboard.”³ In 1998 the House of Representatives did what it could to grant his wish, voting in favor (by a margin of 219 to 209) of a bill to terminate the federal income tax at the end of 2002 (with the tax to be replaced by some unspecified new federal tax).⁴ Despite all the unhappiness and all the attacks, the fabulous invalid is still with us and shows no signs of imminent departure.⁵

The approach of the centenary of the federal income is the occasion for the historical articles in this symposium, focusing on crucial moments in the development of the tax. This introduction provides a preview of the symposium contributions, followed by some speculations on the chances of the income tax surviving for a second hundred years (or at least for a few more decades).

*The Pamela B. Gann Professor of Law, Duke University School of Law.

1. Upon the ratification of the Sixteenth Amendment, U.S. CONST. amend. XVI, in 1913, Congress quickly enacted the first modern federal income tax, the Revenue Act of 1913, ch. 16, 38 Stat. 114.

2. Karlyn Bowman, Amer. Enter. Inst., Public Opinion on Taxes 7–8 (2009), available at <http://aei.org/docLib/AEI-Public-Opinion-Studies-Taxes-2009.pdf> (summarizing results of ORC and Gallup polls asking respondents to choose from among four taxes: federal income tax, state income tax, state sales tax, and local property tax). In the 1990s local property taxes were slightly more unpopular than the federal income tax, and in the 2000s local property taxes were more unpopular than the federal income by a wide margin. *Id.* at 8 (summarizing results of Gallup polls).

3. Barbara Kircheimer, *Archer Addresses Contract Compromises and Reforms*, 66 TAX NOTES 1083, 1083 (1995) (quoting Bill Archer).

4. Tax Code Termination Act, H.R. 3097, 105th Cong. (passed by the House of Representatives, June 17, 1998).

5. The Broadway theater is commonly described as a “fabulous invalid” because it “seems to have played more death scenes than the body count in ‘Hamlet,’ only to be resurrected time and again.” Patty Hartigan, *Terms of Theater Endearment*, BOSTON GLOBE, Oct. 25, 1996, at C3.

I

THE FIRST CENTURY

Tax lawyers—practitioners and academics alike—have long been interested in federal income tax history, but only in history of certain kinds. They are interested in any history that is instrumentally useful to a tax lawyer—including, most obviously and most importantly, legislative history helpful in interpreting the provisions of the current Internal Revenue Code. In the spirit of Christopher Columbus Langdell and his case method of legal instruction,⁶ they are also interested in the leading Supreme Court income tax opinions, even when it is far from clear that knowledge of the cases is crucial—or even useful—in practicing tax law today. One could, for example, probably have a more-than-adequate practical understanding of the realization doctrine as it operates today without ever having heard of *Eisner v. Macomber*,⁷ but every tax practitioner is nevertheless well acquainted with the case.

A great deal of tax history is not within either of these categories of tax lawyers' history, and so is little known. What might be called “losers' tax history”—tax roads considered by Congress but not taken, or taken briefly and then abandoned—is particularly obscure. In the past decade or two, however, the interest of academic tax lawyers in federal income tax history has grown beyond merely instrumental history and the histories of the great cases. The scholarly pioneers in this area—including many of the contributors to this symposium⁸—have taken their tax lawyers' understanding and appreciation of technical detail and applied it beyond the usual narrow scope of tax lawyers' historical interests.⁹

6. See generally Bruce A. Kimball, “Warn Students That I Entertain Heretical Opinions, Which They Are Not to Take as Law”: *The Inception of Case Method Teaching in the Classrooms of the Early C.C. Langdell, 1870–1883*, 17 LAW & HIST. REV. 57 (1999).

7. 252 U.S. 189 (1920) (concluding that the taxation of unrealized gains was not authorized by the Sixteenth Amendment and holding that the taxation of stock dividends was unconstitutional as a tax on unrealized appreciation).

8. See, e.g., STEVEN A. BANK, KIRK J. STARK & JOSEPH J. THORNDIKE, WAR AND TAXES: AMERICA'S UNCERTAIN TRADITION OF WARTIME FISCAL SACRIFICE (2008); Joseph J. Thorndike, “The Unfair Advantage of the Few”: *The New Deal Origins of Soak the Rich Taxation*, in THE NEW FISCAL SOCIOLOGY: TAXATION IN COMPARATIVE AND HISTORICAL PERSPECTIVE 29 (Isaac Martin, Ajay K. Mehrotra & Monica Prasad eds., 2009); Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit*, in MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICAN FAMILIES 15 (Bruce Meyer & Douglas Holtz-Eakin eds., 2001); Anne L. Alstott & Ben Novick, *War, Taxes, and Income Redistribution in the Twenties: The 1924 Veterans' Bonus and the Defeat of the Mellon Plan*, 59 TAX L. REV. 373 (2006); Steven A. Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167 (2002); Charlotte Crane, *Pennington v. Cox: A Glimpse at the Federal Government in the Early Republic*, 23 VA. TAX REV. 417 (2003); Marjorie E. Kornhauser, *Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America*, 50 BUFF. L. REV. 819 (2002); Marjorie E. Kornhauser, *The Morality of Money: U.S. Attitudes Towards Wealth and the Income Tax*, 70 IND. L.J. 119 (1994); Ajay K. Mehrotra, *Mergers, Taxes, and Historical Materialism*, 83 IND. L.J. 881 (2008); Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundations of the U.S. Income Tax*, 52 UCLA L. REV. 1793 (2005).

9. Joseph Thorndike, alone among the contributors to this symposium, is not a lawyer. I hope he

This symposium features nine articles in this spirit of broadened historical inquiry, shedding light on some lesser-known aspects of the history of the federal income tax. Some of the articles describe roads taken (for example, Dennis Ventry's history of the home mortgage interest deduction), while others describe roads not taken (for example, Marjorie Kornhauser's study of the rejection of governmental disclosure of tax-return information of identified high-income individuals). Articles of both types enrich our understanding of how the federal income tax achieved its current contours. The contributors, as a group, share the historian's view that history is interesting and important for its own sake, without regard to whether it happens to contribute to anyone's "presentist agenda." On the other hand, the contributors are mostly lawyers, and as such often cannot (and should not) resist considering the lessons these episodes in tax history may offer to policymakers today.

The articles are presented roughly in the chronological order of the events they describe. Charlotte Crane's article begins by noting that the federal income tax is much more a lawyer's tax ("so intensely a matter of law and legal analysis") than either the income taxes of other jurisdictions or the several nonincome federal taxes.¹⁰ She locates the source of the legalistic nature of the tax in the Supreme Court's 1895 opinion in *Pollock v. Farmers' Loan & Trust Co.*,¹¹ invalidating the income tax of 1894 as a constitutionally impermissible unapportioned direct tax. She describes how the ghost of *Pollock* hovered over the income tax for decades after its reintroduction in 1913, inspiring *Eisner v. Macomber* and other judicial explorations of the constitutional meaning of income. In sharp contrast with other recent commentators, who bemoan the Supreme Court's constitutional policing of the early modern income tax, Crane makes a powerful argument that more good than harm came out of the Court's intense involvement in the development of the tax. She concludes, "The threat of continued [Supreme Court] holdings insisting upon giving constitutional content to the meaning of 'income' forced the Congress and Treasury to commit to a far more consistent and coherent set of rules for defining the tax base."¹²

Ajay Mehrotra's contribution enriches our understanding of the factors contributing to the introduction of the corporate income tax in 1909 and of the individual income tax in 1913.¹³ According to the conventional wisdom, these taxes were the products of politics, political institutions, and social forces; economic factors play a cameo role (at most) in the standard historical accounts. Mehrotra argues convincingly, however, that economic develop-

will take it as a compliment when I observe that his nonlawyer status is not apparent from his scholarship.

10. Charlotte Crane, *Pollock, Macomber and the Role of the Federal Courts in the Development of the Income Tax in the United States*, 73 LAW & CONTEMP. PROBS. 1 (Winter 2010).

11. 158 U.S. 601 (1895).

12. Crane, *supra* note 10, at 21.

13. Ajay K. Mehrotra, *American Economic Development, Managerial Corporate Capitalism, and the Institutional Foundations of the Modern American State*, 73 LAW & CONTEMP. PROBS. 25 (Winter 2010).

ments—especially the emergence of the modern large-scale industrial corporation—were as significant as political and social factors in the enactment and development of the taxes. The corporations created the wealth that became the targets of the corporate and individual taxes. Beyond that, they provided the sophisticated accounting methods and the organizational structures required for effective large-scale administration of the taxes. With the development of modern corporate accounting, it was possible accurately to determine the incomes of corporations, their executives, and their shareholders; and with the availability of corporations as withholding agents and providers of information returns, it was feasible to collect taxes on those incomes.

The income tax treatment of gifts is the subject of Richard Schmalbeck's contribution.¹⁴ He explains that there are four policy options for the combined income tax treatment of a donor–donee pair, and that the best choice among the options is not self-evident. Schmalbeck notes that the current income tax treatment of noncharitable gifts (nondeductible to the donor, nontaxable to the donee) originated with the 1913 income tax. The historical record provides no clues as to why Congress opted for that approach in 1913. As frustrating as this may be, it is an example of an important phenomenon in the development of the income tax. A number of crucial structural decisions made in the early days of the income tax, which continue to shape the current income tax, were made without (so far as we can now tell) any meaningful deliberation. Schmalbeck also provides an illuminating account—in terms of both history and policy—of the income tax treatment of appreciation in gratuitously transferred property.

Joseph Thorndike's article explores the Keynesian conversion of Treasury Department tax-policy experts during the 1930s.¹⁵ At the beginning of the Great Depression, Thorndike writes, there was no political interest in using tax cuts to promote economic recovery. In fact, in 1932 Congress responded to the economic emergency by enacting a tax *increase* in the name of fiscal responsibility. By 1937, however, Treasury experts had become persuaded of the merits of countercyclical taxation. Ironically, the first legislative experiment in Keynesian taxation took the form of a tax *increase*—the short-lived 1937 tax on undistributed corporate profits, intended to stimulate the economy by discouraging corporations from hoarding cash. As Thorndike explains, the use of income tax *cuts* as weapons in the countercyclical arsenal requires the existence of a tax imposed on the bulk of the population, and the income tax did not become a mass tax until World War II. Keynesian tax cuts emerged in the postwar era, the product of both the intellectual conversion of the tax experts during the 1930s and the creation of the mass income tax during the following decade.

Marjorie Kornhauser's article rescues from oblivion a fascinating piece of

14. Richard Schmalbeck, *Gifts and the Income Tax—An Enduring Puzzle*, 73 LAW & CONTEMP. PROBS. 63 (Winter 2010).

15. Joseph J. Thorndike, *The Fiscal Revolution and Taxation: The Rise of Compensatory Taxation, 1929–1938*, 73 LAW & CONTEMP. PROBS. 95 (Winter 2010).

tax history.¹⁶ As Kornhauser recounts, legislation enacted in 1934 required all income taxpayers to submit “pink slips” with their tax returns. The information required by the pink slip—the taxpayer’s name, address, gross income, deductions, taxable income, and tax liability—would then be made available for public inspection. The disclosure regime was repealed less than one year later, largely through the remarkably effective efforts of one person—Raymond Pitcairn, a wealthy lawyer. Kornhauser describes a multifaceted public-relations campaign, orchestrated by Pitcairn, that would be sophisticated even by today’s standards. Two aspects of Pitcairn’s campaign were especially impressive. The first was his ability to enlist the *zeitgeist* in his efforts; the trial of Bruno Hauptmann for the kidnapping and murder of the Lindbergh baby was proceeding as Pitcairn was advocating repeal of the disclosure requirement, and Pitcairn argued effectively that the disclosure requirement would encourage additional kidnappings. The second was his ability to convince Congress and the public that repeal was in the interests of the “common man,” despite the inconvenient fact that the income tax applied to less than ten percent of the population.

My own article explores another path not taken.¹⁷ It is well known that the income tax became a mass tax during World War II; it is less well known that Congress came close to enacting a federal retail sales tax to help finance the war, instead of (or perhaps in addition to) the mass income tax. The article describes the competition during the war between the proponents of the income tax as the instrument of mass taxation and the proponents of the sales tax alternative. It argues that Congress almost certainly would have enacted a wartime sales tax, were it not for the implacable—and puzzling—opposition of President Roosevelt. But for Roosevelt’s hostility to the sales tax, it is quite possible that the United States would have emerged from the war with a sales tax as the federal instrument of mass taxation, and with the income tax as a class tax imposed only on the affluent. The article suggests that postwar developments in federal taxation would have been very different if the United States had emerged from the war with a retail-sales-tax-plus-class-income-tax, instead of the actual mass income tax.

Steven Bank’s article describes the fate of post–World War II proposals to provide legislative relief from double taxation.¹⁸ Although reduction of the double-tax burden was frequently on the legislative agenda in the years following the war, no relief was enacted until 1954. Even then the relief was modest and, in large part, short-lived. Bank flags the parallel with the dividend-tax relief enacted in 2003, which also fell well short of the elimination of double

16. Marjorie E. Kornhauser, *Shaping Public Opinion and the Law: How a “Common Man” Campaign Ended a Rich Man’s Law*, 73 LAW & CONTEMP. PROBS. 123 (Winter 2010).

17. Lawrence Zelenak, *The Federal Retail Sales Tax That Wasn’t: An Actual History and an Alternate History*, 73 LAW & CONTEMP. PROBS. 149 (Winter 2010).

18. Steven A. Bank, *The Rise and Fall of Post–World War II Corporate Tax Reform*, 73 LAW & CONTEMP. PROBS. 207 (Winter 2010).

taxation, and which is scheduled to expire at the end of 2010. Perhaps the last word on this topic, as quoted by Bank, belongs to House Ways and Means Chairman Robert Doughton. Asked in 1945 about the prospects for double-tax relief, Doughton commented, “That’s an old subject and it’s likely to be an old one after someone else becomes chairman of this committee.”¹⁹ His quip has lost none of its timeliness over the past sixty-five years.

Dennis Ventry’s definitive history of the home mortgage interest deduction covers the entire lifespan of the modern income tax.²⁰ The deduction originated in 1913, as part of a general provision allowing a deduction for all interest, rather than as a specific provision governing home mortgage interest. There is no indication that the 1913 Congress intended the interest deduction to promote or reward homeownership. Indeed, the deduction could not possibly have had any widespread effect on homeownership so long as the income tax applied to only a small percentage of the population. The deduction came into its own after World War II, as the conversion of the income tax to a mass tax made it available to millions of homeowners. By the 1950s the deduction was widely recognized by tax-policy experts as a housing subsidy, and just as widely denounced as inequitable and inefficient. Ever since then, experts have advocated the elimination or radical transformation of the deduction, and Congress has ignored their advice. Ventry concludes with a powerful argument for repeal of the deduction, but the history he recounts suggests the deduction may be immune to even the most powerful arguments against it. The federal income tax has long featured double taxation of corporate income, with income taxed once at the corporate level when earned by the corporation and again at the shareholder level when received as a dividend.

In her article, Anne Alstott critically examines the near-consensus claim that the earned income tax credit (EITC) has succeeded in “making work pay” for low-wage parents.²¹ She begins by arguing that the official poverty levels are unrealistically low and proposes higher levels based on prevailing social judgments as to what constitutes a decent minimum standard of living. Using her definition of poverty, she concludes that the EITC makes only a small reduction in poverty, does not enable a minimum-wage worker to support herself and even one child at or above the poverty level, and does nothing for the involuntarily unemployed and others willing but unable to work. Alstott’s analysis suggests some intriguing (if ultimately unanswerable) historically based questions. If Congress had not enacted the EITC in 1975, would low-wage families in the United States be better off or worse off today? Is the EITC, despite its inadequacies, the best that Congress is likely ever to do for the

19. *Id.* at 214 (quoting Robert H. Doughton, as quoted in John H. Crider, *Doubts Tax Cuts Till Budget is Met*, N.Y. TIMES, Dec. 20, 1945, at 16).

20. Dennis J. Ventry, Jr., *The Accidental Deduction: A History of the Tax Subsidy for Mortgage Interest*, 73 LAW & CONTEMP. PROBS. 233 (Winter 2010).

21. Anne L. Alstott, *Why the EITC Doesn’t Make Work Pay*, 73 LAW & CONTEMP. PROBS. 285 (Winter 2010).

working poor? Or has the EITC taken the edge off of poverty just enough to prevent the enactment of a more effective program?

II

A SECOND CENTURY?

With the fabulous invalid almost certain to reach its one-hundredth birthday, it is time to think about its second century. As Zagar and Evans might have asked (at the risk of being no-hit wonders rather than one-hit wonders), in the year 2113, will the income tax still be alive?²² The first step in attempting to answer the question is definitional: What feature or features make the income tax the income tax so that, if those features disappeared, the income tax would cease to exist?

Ask that question of a tax-policy expert, and you will be told that the defining features of an income tax are that it taxes saved income (in addition, of course, to taxing income devoted to current consumption) and that it taxes the investment return on savings.²³ The taxation of saved income distinguishes the income tax from a consumption tax, and the taxation of investment returns distinguishes the income tax from a wage tax. Of course, the actual income tax has never reached all saved income or all investment returns. In the early 1980s the actual income tax fell so far short of a comprehensive income tax base as to lead some to question whether it could still be properly called an income tax.²⁴ (The Tax Reform Act of 1986 pulled the income tax back from the consumption tax brink.²⁵) Similarly, when President George W. Bush's Advisory Panel on Federal Tax Reform presented (as one of two reform options) a proposal for a tax adopting the consumption tax approach of immediate deduction of the costs of all long-lived business assets, it was careful *not* to label the proposal an income tax.²⁶

22. RICK EVANS, *IN THE YEAR 2525 (EXORDIUM AND TERMINUS)* (1969) ("In the year 2525, if man is still alive, if woman can survive, they may find . . .").

23. The inclusion in the income tax base of savings and of investment returns follows from the standard economist's definition of a person's income for a particular period as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and the end of the period in question." HENRY SIMONS, *PERSONAL INCOME TAXATION* 50, 61–62, 206 (1938).

Although "income" tax and "consumption" tax labels are used to describe distinctly different tax bases in the standard usage of experts, there are also—confusingly enough—nonstandard expert usages according to which some types of consumption taxes are considered to be income taxes. For a survey of such usages, see Lawrence Zelenak, *Radical Tax Reform, the Constitution, and the Conscientious Legislator*, 99 *COLUM. L. REV.* 833, 850–54 (1999).

24. See, e.g., Marvin A. Chirelstein, *Back From the Dead: How President Reagan Saved the Income Tax*, 14 *FLA. ST. U.L. REV.* 207, 219–23 (1986).

25. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

26. The President's Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System 163–64 (2005) (describing the expensing of business assets under the "Growth and Investment Tax Plan").

History, in addition to expert usage, supports the notion that the taxation of investment income is a necessary feature of an income tax. In *Pollock v. Farmers' Loan & Trust Co.*,²⁷ the Supreme Court held that the federal income tax enacted in 1894²⁸ was unconstitutional as an unapportioned “direct” tax.²⁹ The Court reasoned that the tax on investment income (from both real and personal property) was an unapportioned direct tax and that the unconstitutional tax on investment income could not be severed from the otherwise constitutional tax on labor income.³⁰ Congress could have responded to *Pollock* simply by enacting a new tax applicable only to salaries and wages, but it considered the taxation of investment income so crucial that it delayed its response to *Pollock* for almost two decades, until ratification of the Sixteenth Amendment made possible the enactment of a valid unapportioned tax “on incomes, from whatever source derived,” applicable to both labor and investment income.³¹

Despite expert usage and history, I doubt if the experts’ notion of what distinguishes an income tax from a consumption tax or a wage tax looms very large in the public’s conception of what makes the income tax the income tax. I suspect the public, if asked,³² would identify four defining features of the federal income tax: (1) it is a mass tax, imposed on the bulk of the population; (2) it is imposed directly on individuals as taxpayers (as contrasted with the indirect effects of a retail sales tax or a value-added tax); (3) it features progressive marginal tax rates; and (4) it uses exclusions, deductions, and credits to adjust tax liabilities in response to various aspects of taxpayers’ economic circumstances. Perhaps the public would also include (as the experts would think it should) a fifth feature: (5) its base is income, as distinguished from either wages or consumption. My guess, however, is that the fifth feature is

27. 158 U.S. 601 (1895).

28. Revenue Act of 1894, ch. 349, 28 Stat. 509 (1894).

29. Apportionment of direct taxes, among the states according to their populations, is required by the Constitution. U.S. CONST. art. I, § 2, cl. 3; art. I, § 9, cl. 4.

30. 158 U.S. at 635–37.

31. As the history recounted in the text suggests, there is a constitutional dimension to the question whether a tax is an income tax. If an unapportioned tax is a “direct” tax (within the meaning of U.S. CONST. art I, § 2 cl. 3; art. I, § 9, cl. 4), it is constitutional only if it qualifies as a tax on “incomes” (within the meaning of the Sixteenth Amendment). This raises the possibility that some fundamental tax reforms, involving the replacement of the income base with a consumption base, could be unconstitutional as unapportioned direct taxes not authorized by the Sixteenth Amendment (because they are not imposed on “incomes”). See Erik M. Jensen, *The Apportionment of “Direct Taxes”: Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334 (1997) (arguing that two commonly proposed fundamental tax reforms would be unconstitutional); Zelenak, *supra* note 24 (arguing the contrary position). My interest in this Foreword is not in the meaning of “incomes” as used in the Sixteenth Amendment, but rather in the cultural meaning of the federal income tax as that meaning has developed over the decades of the tax’s existence.

32. There has been extensive public opinion polling on a wide range of tax issues, but to the best of my knowledge there has never been any polling concerning what features of the income tax are crucial to its identity. The absence of such polling questions is not surprising because the answers to the questions would not reveal whether the respondents supported or opposed those features.

considerably less perspicuous to the public than the first four. Whether or not the tax base includes investment income is of little or no personal interest to most taxpayers because most taxpayers have little or no investment income.³³ Similarly, that the tax base includes some saved income is of little or no personal interest to most taxpayers, both because they currently consume the bulk of their earnings and because most of what they do save is excluded from their tax base under either the rules governing qualified employment-based retirement savings or the rules governing individual retirement accounts.³⁴

If I am right about the public's sense of what makes the income tax what it is, is the public wrong to attach greater significance to four features that do not appear in the experts' definition of an income tax than to the experts' defining feature? The imagined question to the public is about the essence of the income tax—what makes the tax what it is—*not* about the source of the name of the tax. If the tax happened to be named after its rate structure instead of its base³⁵—the “unflat tax” instead of the “income tax”—that would have no effect on the essence of the tax. It is not unusual for things to be named after their incidental features rather than their essential features. A Protestant denomination might not consider its historical origins in a protest movement to be an essential feature of its faith, and its creed might not even mention the protest; yet the protest is the source of its name.³⁶ Similarly, the income base of the income tax might be no more important—might even be less important—than the other four defining features, despite being the source of the name.

The survival of the core of the current federal tax *called* the income tax does not depend uniquely on whether there continues to be a federal tax with an income base. Some prominent scholars plausibly claim that the difference between an income base and a consumption base is of only limited significance, because (1) taxpayers can and do avoid income taxation of risky investment returns by making portfolio adjustments in response to the tax, and (2) the unavoidable income taxation of the risk-free rate of return is almost trivial, given how low the risk-free rate of return has been over most of the past century.³⁷ If those scholars are right, then the income tax base may be the *least*

33. On 2006 income tax returns, solidly middle-income taxpayers—with adjusted gross incomes in the range of \$75,000 to \$100,000—reported taxable interest income aggregating only 2.4% of their aggregate salaries and wages, reported dividends aggregating only 1.8% of salaries and wages, and reported capital gains (including both capital gains distributions and net gains on sales of capital assets) aggregating only 3.0% of salaries and wages. Author's calculations, based on Justin Bryan, *Individual Income Tax Returns, 2006*, 28 STAT. INCOME BULL. 5, 21–22 tbl. 1 (2008).

34. I.R.C. §§ 219 (individual retirement accounts), 401 (qualified employment-based retirement savings).

35. The so-called flat tax, developed by Robert E. Hall and Alvin Rabushka and popularized largely by Steve Forbes, is an example of a (proposed) tax named after its rate structure rather than its base. ROBERT E. HALL & ALVIN RABUSHKA, *THE FLAT TAX* (2d ed. 1995).

36. COMPACT OXFORD ENGLISH DICTIONARY OF CURRENT ENGLISH, “Protestant,” *available at* www.askoxford.com/dictionaries/compact_oed/?view=uk (stating that the word is derived from the dissent of Martin Luther and his followers from the Diet of Spires).

37. *See, e.g.*, David A. Weisbach, *The (Non)Taxation of Risk*, 58 TAX L. REV. 1 (2004). *But see*

important of the five defining features of the so-called income tax. In short, it would be perfectly reasonable for the public to believe that the taxation of income (as contrasted with the taxation of consumption or wages) is not of the essence of the current federal income tax.

Different proposals for substantially modifying or replacing the current federal income tax would result in the survival of different numbers of the five features of the current tax. The chart on the facing page indicates which features would persist following the adoption of five leading reform proposals. For purposes of the chart, the first two features of the current income tax—mass taxation and direct taxation of individuals—are combined into a single feature, mass direct taxation of individuals. This is because any plausible replacement for the income tax would have to involve mass taxation; the interesting question is whether that mass taxation would be direct (as with the current income tax) or indirect (as with a retail sales tax or value-added tax (VAT)).

The five proposals considered are (1) Michael Graetz's proposal to introduce a federal VAT, retaining the income tax only for those taxpayers with six-figure incomes;³⁸ (2) the "Growth and Investment Tax Plan" (GITP), featuring immediate deductions for the cost of all long-lived business assets, proposed in 2005 by the President's Tax Reform Panel;³⁹ (3) the "flat tax" proposed by Robert E. Hall and Alvin Rabushka, which would have two components—(a) a flat-rate business tax imposed on a base identical to the base of a VAT, except that a deduction for salaries and wages paid would be allowed, and (b) a tax imposed on individuals, at the same flat rate, on salaries and wages in excess of a rather high exemption level;⁴⁰ (4) a federal retail sales tax (or VAT) introduced as a complete replacement for the federal income tax;⁴¹ and (5) a "cash flow" consumption tax with progressive marginal tax rates, resembling the current income tax except that (a) all savings would be deductible and (b) all consumption spending would be taxable (including spending financed by savings and spending financed by borrowing).⁴²

Lawrence Zelenak, *The Sometimes-Taxation of the Returns to Risk-Bearing Under a Progressive Income Tax*, 59 SMU L. REV. 879, 889–90 (2006) (suggesting that the historically low, inflation-adjusted, risk-free rates of return may not be a good indication of real risk-free rates of return in the future).

38. Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261 (2002).

39. The President's Advisory Panel, *supra* note 27, at 163–64 (describing the treatment of the cost of long-lived business assets under the GITP).

40. HALL & RABUSHKA, *supra* note 36.

41. NEAL BOORTZ & JOHN LINDER, *THE FAIR TAX BOOK* (2005) (arguing that the federal income tax should be replaced by a federal retail sales tax).

42. Edward McCaffery has been the leading academic advocate of such a system. *See, e.g.*, EDWARD J. MCCAFFERY, *FAIR NOT FLAT: HOW TO MAKE THE TAX SYSTEM BETTER AND SIMPLER* (2002).

Features → Proposal ↓	Mass direct taxation of individuals?	Progressive marginal rates?	Significant use of exclusions, deductions, and credits?	Tax imposed on saved income and investment returns?	Number of retained features of current income tax
VAT-plus-elite income tax	no	yes ⁴³	no ⁴⁴	yes ⁴⁵	2
The GITP	yes	yes	yes	no ⁴⁶	3
The flat tax	yes	no ⁴⁷	no ⁴⁸	no	1
Sales tax (or VAT)	no	no ⁴⁹	no	no	0

43. Graetz proposes a single rate for the income tax imposed on six-figure incomes. Graetz, *supra* note 39, at 284. Viewing the VAT and the elite income tax as an integrated system, however, the combined rate of the VAT and the income tax (applicable to high-income persons) would be higher than the stand-alone rate of the VAT (applicable to low- and moderate-income persons).

44. The “no” characterization is debatable. The elite income tax would retain deductions for home mortgage interest, charitable contributions, and medical expenses, and a replacement for the earned income tax credit (EITC) for low-income workers would be introduced into the payroll-tax system. Graetz, *supra* note 39, at 295–96 (income tax deductions), 290–93 (EITC replacement). However, for the majority of the population neither eligible for the EITC replacement nor subject to the income tax, the “no” characterization would clearly be correct.

45. The “yes” characterization is debatable because tax would not be imposed on the saved income and investments returns of the majority of the population not subject to the elite income tax. On the other hand, the bulk of saved income and investment returns would belong to the minority of taxpayers subject to the income tax, so the “yes” characterization seems appropriate.

46. Actually, the GITP would retain a sort of residual tax on investment returns—a fifteen percent tax rate applicable to dividends, capital gains, and interest. The President’s Advisory Panel, *supra* note 27, at 152, 159. The panel considered this residual taxation insufficient to justify describing the EITC as an income tax, and that judgment seems reasonable.

47. Although the flat tax as proposed by Hall and Rabushka has only one positive tax rate, the exemption allowance under the wage tax portion of the flat tax functions as a zero bracket. Thus, the tax can be understood as really featuring two tax brackets—a zero-rate bracket and one positive-rate bracket. In addition, the structure of the wage-tax portion is readily adaptable to the introduction of any number of progressive marginal rates, if Congress should so desire. See David F. Bradford, *What are Consumption Taxes and Who Pays Them?*, 39 TAX NOTES 383, 385–86 (1988) (describing the “X tax,” under which progressive marginal rates would apply to the wage-tax portion of the flat tax).

48. Although the flat tax as proposed by Hall and Rabushka does not allow any deductions (other than the personal allowances designed to shelter subsistence-level income from the wage tax), there would be no technical difficulty in introducing exclusions, deductions, and credits into the wage-tax portion of the flat tax.

49. The Boortz and Linder sales tax proposal features a “prebate”—a universal refund of the sales tax on subsistence consumption—which mimics the effect of a tax with a zero rate on subsistence consumption and a single positive rate on above-subsistence consumption. BOORTZ & LINDER, *supra* note 42, at 81–90.

Features → Proposal ↓	Mass direct taxation of individuals?	Progressive marginal rates?	Significant use of exclusions, deductions, and credits?	Tax imposed on saved income and investment returns?	Number of retained features of current income tax
Progressive cash flow tax	yes	yes	yes	no ⁵⁰	3

As indicated in the right-hand column of the table, two of the proposals that would be considered non-income tax proposals under the standard usage of tax experts—the GTP and the progressive cash flow tax—actually retain three of the four defining features of the current income tax. A proposal that *would* be considered an income tax proposal under standard expert usage—the VAT-plus-elite-income-tax—retains only two of the four defining features.

Of course, a glance at the numbers in the right-hand column is not sufficient to determine whether the current federal income tax would persist in essence—even if not in name—if a particular reform proposal were adopted. Even if it were reasonable to conclude that the essence of the current tax system survives when the replacement system retains a majority of the defining features of the current system and that the essence does not survive when the replacement system retains only a minority of those features, there would still be the problem of how to view a replacement that retains exactly half of those features (as in the case of the VAT-plus-elite income tax).⁵¹ Moreover, merely counting features is not enough to resolve all doubts even if the replacement retains three features, or only one feature. Counting is inadequate both because it is not necessarily the case that all features are equally significant⁵² and because in

50. However, as McCaffery explains, a progressive cash-flow tax will impose a burden on the returns to savings of a taxpayer who saves in a low-consumption year to finance a high level of consumption in a later year. Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807, 814–15 (2005).

51. This tie-breaking problem will remind tax lawyers of a certain vintage of the old regulations governing when a partnership would be classified as a corporation for federal income tax purposes: the regulations identified four crucial characteristics of corporations and indicated that a partnership would be treated as a corporation only if it had at least three of those characteristics. Treas. Reg. § 301.7701-2 (e.g., 1983).

52. As shown in the table, the flat tax has only one income-tax-like feature—the mass direct taxation of individuals. Although the presence of only one feature suggests the flat tax is not an income tax, that conclusion is not inevitable if one puts tremendous weight on that one feature, or on some feature not included in the table. Former Ways and Means Committee Chairman Bill Archer wanted to replace the income tax with a federal retail sales tax or VAT. Clay Chandler, *Archer Calls for End to Income-Based Tax*, WASH. POST, June 6, 1995, at D1. Archer's opposition to income taxation extended to the Hall–Rabushka flat tax because he viewed it as a type of income tax: “In my opinion, if your wages are going to be taxed before you get them, that’s an income tax.” Jacqueline Rieschick, *March Madness Spurs Trash Talk on Tax Reform*, 78 TAX NOTES 1209, 1210 (1998) (quoting Archer). Archer's remark suggests that, for him, withholding at the source was the essence of income taxation.

many cases it is debatable whether a replacement should or should not be characterized as retaining a particular feature (a problem suggested by the footnotes to eight of the twenty yes-or-no answers in the table). Subject to all of these qualifications, however, it would not be unreasonable to conclude both (1) that the essence of the current federal income tax would survive the adoption of either the GITP or a progressive cash flow tax (despite the loss of the experts' income tax label in both cases), and (2) that the essence of the current federal income tax would not survive the adoption of the VAT-plus-elite income tax (despite the survival of a tax with an income base).

If one accepts the multi-feature account of the essence of the current federal income tax system (despite its undeniable lack of precision), how would one evaluate the system's long-term prospects? Crystal-ball-gazing a century into the future may be a hopeless exercise. Who, in 1913, could have predicted the events—from the Great Depression, to World War II and the Cold War, to the Reagan Revolution—that shaped the development of the income tax in its first century? And who has any idea today what the United States will be like in 2113? (How much of it, for example, will be under water?) Less ambitiously, however, it may be possible to make meaningful prognostications over the next decade or two.

The survival of the income tax over that shorter time frame is likely under the multi-feature approach to defining survival. By contrast, the survival of the income tax would be very doubtful under an approach focused exclusively on the propriety (according to the usual terminology of experts) of the continued use of the income tax label. Income as a tax base may be in serious trouble over the next few decades. The George W. Bush Administration repeatedly proposed “Retirement Savings Accounts” (RSAs) and “Lifetime Savings Accounts” (LSAs) that would have greatly expanded the availability of wage-tax treatment for savings.⁵³ The long-term strategy seemed to be a sort of slouching away from an income tax base, culminating in a tax system with too little remaining taxation of investment income to be fairly described as an income tax. Although the Bush Administration did not achieve this goal, and the Obama Administration has shown no interest in pursuing it, it is easy to imagine future administrations and Congresses—particularly Republican ones—reviving RSA and LSA proposals and perhaps prevailing. A tax reward for thrifty savers has obvious political appeal, and the incrementalism of the approach is more likely to succeed than any attempt to eliminate all vestiges of an income tax base in one fell swoop. Although there may be only an attenuated connection in the tax arena between intellectual movements and

53. See, e.g., Patti Mohr, *White House Begins Selling Its Tax Cut to Congress*, 98 TAX NOTES 631, 633–34 (2003); U.S. Dep't of the Treasury, *General Explanation of the Administration's Fiscal Year 2007 Revenue Proposals 5–10* (2006). Contributions to RSAs and LSAs would not have been deductible, but the investment returns would have been permanently tax-exempt. The Bush Administration's RSA and LSA proposals were the inspiration for the “Save for Retirement” and “Save for Family” account proposals of the President's Tax Reform Panel. The President's Advisory Panel, *supra* note 27, at 119–21, 159.

political outcomes, it is also worth noting that income as a tax base has lost much of its support among tax-policy experts in the past few decades. A generation ago, a comprehensive income tax base was the policy darling of most tax-policy experts, but today most experts—including a substantial number on the political left—oppose the income tax base.⁵⁴ All things considered, then, the long-term-survival chances for income as the tax base are not particularly good.

By contrast, the long-term-survival chances for the other defining features of the current income tax—mass direct taxation of individuals; significant use of exclusions, deductions, and credits; and a modestly progressive marginal tax rate structure—seem quite good. As Michael Graetz has wryly observed, in recent years Congress has “used the income tax the way [his] mother employed chicken soup: as a magic elixir to solve all the nation’s economic and social difficulties. If the nation has a problem in access to education, child-care affordability, health-insurance coverage, or the financing of long-term care, an income tax deduction or credit is the answer.”⁵⁵ As Graetz explains, the attraction is bipartisan—Republicans like almost any tax cut, and Democrats realize their favorite spending programs are more politically viable as tax expenditures than as direct expenditures.⁵⁶ Moreover, members of the House Ways and Means and Senate Finance Committees can increase their campaign contributions by sending the message that they are always open to the enactment of new tax subsidies.⁵⁷ And the administrative costs of delivering subsidies through the income tax are generally much lower than the administrative costs of delivering nontax subsidies.⁵⁸

In short, Congress seems hopelessly addicted to the extensive use of exclusions, deductions, and credits in lieu of direct spending programs—and thus also addicted to the existence of mass direct taxation of individuals as the vehicle for the delivery of subsidies. By now, the addiction seems so strong that even if (in some alternate universe) there were no need for a revenue-producing direct mass tax, Congress might opt for a zero-revenue direct mass “tax” solely for its usefulness as a vehicle for delivering subsidies. There might never have been a direct mass tax,⁵⁹ but once such a tax was enacted and Congress discovered the joys of tax expenditures, the elimination of direct mass taxation became very unlikely.

54. See Daniel Shaviro, *Beyond the Consumption Tax Consensus*, 60 STAN. L. REV. 745, 746–47 (2007) (describing the shift in expert opinion); MCCAFFERY, *supra* note 43 (an example of a left-of-center opponent of the income tax base).

55. Graetz, *supra* note 39, at 274.

56. *Id.* at 275.

57. Sixth Meeting of the President’s Advisory Panel on Federal Tax Reform 117–18 (2005) (remarks of Milton Friedman); Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913 (1987).

58. See, e.g., Janet Holtzblatt, *Choosing Between Refundable Tax Credits and Spending Programs*, in 93 PROC. ANN. CONF. ON TAX’N 116, 122 (2001) (comparing the substantial direct administrative costs of the Food Stamps program with the minimal direct administrative costs of the earned income tax credit).

59. See Zelenak, *supra* note 18.

The survival of progressive marginal rates does not seem quite as assured as the survival of direct mass taxation and tax expenditures. The intellectual foundation of progressive marginal tax rates has been undermined by optimal-tax analysis. The objective of optimal-tax analysis⁶⁰ is to determine what marginal tax rate structure, in combination with a system of universal cash transfers, will maximize a chosen social-welfare function (SWF)⁶¹ under various assumed conditions (relating to the distribution of wage-earning abilities in society, the elasticity of the labor supply, and the rate at which the marginal utility of money declines). Different optimal-tax simulations, based on different factual assumptions and using different SWFs, can produce very different levels of transfer payments and very different levels of taxation. However, as a leading optimal-tax scholar has explained, “One of the main conclusions to be drawn from the Mirrleesian optimal nonlinear income tax model is that it is difficult (if at all possible) to find a convincing argument for a progressive marginal tax rate structure throughout” the societal wage distribution.⁶² As in the case of the shift in expert opinion concerning the relative merits of income taxation and consumption taxation,⁶³ it is difficult to predict how much—if at all—a change in academic views will influence political outcomes.

Public attitudes toward progressive marginal rates are probably more important politically than the views of academics. In this regard it is noteworthy that Robert E. Hall and Alvin Rabushka, the developers of the particular consumption-tax proposal known as *the* (as opposed to *a*) flat tax, were sufficiently persuaded of the political attractiveness of a single (“flat”) rate that they named their tax after its rate structure, rather than follow the nearly universal approach of naming taxes after their bases.⁶⁴ On the other hand, opinion polling indicates considerable public support for progressive tax rates,⁶⁵

60. See, e.g., J.A. Mirrlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 REV. ECON. STUD. 175 (1971) (the seminal work in the field); MATTI TUOMALA, *OPTIMAL INCOME TAX AND REDISTRIBUTION* (1990) (a comprehensive monograph on optimal income taxation); Lawrence Zelenak & Kemper Moreland, *Can the Graduated Income Tax Survive Optimal Tax Analysis?*, 53 TAX L. REV. 51 (1999) (including a nontechnical introduction to optimal income tax analysis).

61. An SWF specifies how the well-being of individuals contributes to the overall well-being of society. A simple utilitarian SWF, for example, values equally the well-being of each member of society. At the other extreme, a “maximin” social-welfare function—commonly associated with the political philosophy of John Rawls—is concerned solely with the well-being of the least well-off members of society. JOHN RAWLS, *A THEORY OF JUSTICE* 75–83, 152–56 (1971).

62. TUOMALA, *supra* note 61, at 14. For a wide range of factual assumptions and SWFs, optimal tax-rate structures feature rising marginal rates through the bottom decile of the wage distribution, and *falling* marginal tax rates through the remaining nine deciles. *Id.* at 95–99. *But see* Zelenak & Moreland, *supra* note 61, at 62–71 (demonstrating that optimal tax analysis *does* support progressive marginal tax rates in the absence of universal cash transfers and arguing that universal cash transfers are politically unrealistic in the United States).

63. See *supra* text accompanying note 55.

64. HALL & RABUSHKA, *supra* note 36.

65. See Bowman, *supra* note 2, at 26 (reporting results of a 1981 Harris Interactive poll, in which a majority of respondents found it was “fair” that “higher-income people not only have to pay more in taxes but must pay a greater percentage of their income in taxes,” and of a 2005 AP-Ipsos poll in which a majority of respondents thought that those “who earn more money should pay a higher tax rate on

and in the quarter century since the flat tax was originally proposed⁶⁶ neither the Hall–Rabushka tax nor any other single-rate tax has even come close to enactment as a replacement for the current federal income tax. The George W. Bush Administration, for example, demonstrated no interest in eliminating progressive marginal tax rates—in marked contrast with its strong interest in moving toward a consumption-tax base.⁶⁷

Moreover, it is debatable whether the Hall–Rabushka proposal, and other proposals for taxes with a single positive rate, are accurately described as flat-rate tax proposals. In fact, the wage-tax portion of the Hall–Rabushka proposal (like most other so-called single-rate proposals) actually features two tax rates—a zero rate on subsistence-level wages produced by “a generous personal allowance” in the wage tax,⁶⁸ and one positive rate imposed on above-subsistence wages. Hall and Rabushka do not think this prevents their tax from being flat. In this respect they are intellectual heirs of Walter Blum and Harry Kalven, who argued that a tax applying a single positive rate above an exemption level was different in kind, rather than merely in degree, from a tax with multiple positive rates—so much so that they gave the single-positive-rate tax its own adjective, “degressive.”⁶⁹ Despite the protestations of Hall, Rabushka, Blum, and Kalven, a tax featuring a single positive rate above an exemption level has both of the features essential to a progressive marginal tax rate structure—that is, the existence of more than one tax rate, and the application of the higher rate(s) to higher levels of income.

A forecast limited to the next few decades might predict that (1) the survival of progressive marginal tax rates in the narrower sense of the term—requiring the existence of at least two positive rates of tax—is probable, and (2) the survival of progressive marginal tax rates in the broader sense of the term—as including the “degressive” rate structures of Blum and Kalven—is nearly certain.

To sum up the probable life expectancies of the major features of the existing income tax: Although the income tax base is in considerable peril, two of the other features—mass direct taxation of individuals and the continued availability of an array of exclusions, deductions, and credits—are almost certain to survive for decades, and the final feature—progressive marginal rates—is more likely than not to survive. If the income tax base disappears, but two or three of the remaining features persist, would the resulting tax still be the

their incomes than people who earn less.”

66. ROBERT E. HALL & ALVIN RABUSHKA, *THE FLAT TAX* (1st ed., 1985).

67. The Executive Order creating the President’s Advisory Panel on Federal Tax Reform instructed the Panel that its proposals should be “appropriately progressive.” Exec. Order No. 13,369, 70 Fed. Reg. 2323 (Jan. 7, 2005). By contrast, the order indicated the panel could offer one or more non-income tax proposals, as long as it offered at least one option “us[ing] the Federal income tax as the base for its recommended reforms.” *Id.*

68. HALL & RABUSHKA, *supra* note 36, at 54.

69. Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 506–16 (1952).

income tax? Reasonable minds can differ on the answer to that question. There is much to be said, however, in favor of a “yes” answer. The survival of an income base, as contrasted with a consumption base or a wage base, may not be necessary to the survival of the core of the current federal income tax. There is no objective way of determining something as amorphous as the essence of a tax system, so there is no reason to expect a consensus as to whether the essence of the income tax would have survived in various possible futures. The argument offered in this foreword is negative—not in favor of any particular view of the essence of the current federal income tax, but against the assumption that the “income tax” label captures the essence of the tax.

The focus here is on the survival of essential features, not of labels; but it would not be surprising if the income tax label—as well as the income tax essence—survived the decline and fall of the income tax base. Suppose that over the next few decades Congress gradually slouched away from an income tax base, eventually arriving at a point at which the tax base could no longer be fairly described as income, but without disturbing the other key features of the current system. It would be reasonable to conclude that the core of the current tax system had survived, even if tax experts would say the tax was no longer an income tax. It also seems likely that the income tax label would survive the gradual dismantling of the income tax base. A cynic might attribute the survival of the income tax label to the boiling frog effect—just as urban legend claims that a frog will allow itself to be boiled to death as long as the water temperature is raised gradually,⁷⁰ perhaps the income tax label can endure as long as the income tax base is gradually eroded. But the label might also survive for a better reason. The income tax label may have come to be understood nonliterally—as a shorthand reference to the several key features of the current tax system, rather than as a literal description of the base of the tax. There are instances of things being named after nonessential features, losing those nonessential features, and retaining their names—think of the nongreen greenrooms of television fame,⁷¹ or (for tax aficionados) the nonblue bluebooks produced by the Staff of the Joint Committee on Taxation.⁷² Perhaps the income tax is destined to become another example of that phenomenon.

70. See, e.g., Paul Krugman, *Boiling the Frog*, N.Y. TIMES, July 13, 2009, at A19 (“Real frogs will, in fact, jump out of the pot—but never mind. The hypothetical boiled frog is a useful metaphor . . .”).

71. See William Safire, *The Greenroom Effect*, N.Y. TIMES MAG., Apr. 23, 1989, at 16 (explaining that the use of the term in the theater predates the advent of television by several centuries, that the term may or may not have been based on the wall color of early greenrooms (the origins of the term are lost in the mists of time), and that the term is routinely used today even when nothing in a particular greenroom is actually green).

72. Bluebooks are prepared by the Staff of the Joint Committee of Taxation to describe recently enacted tax legislation. See, e.g., Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 110th Congress (JCS-1-09). Their covers are frequently gray, but that does not affect their status as bluebooks.