BOOK REVIEW


In 1962, the Section of Taxation of the American Bar Association undertook a pilot project study of substantive tax reform. That study recently has been announced as completed and the results published jointly by the American Bar Foundation and Southern Methodist University. The collection of essays and the report of data obtained from the study indicate that lawyers have fallen short of making an important contribution to the study, except to the extent that one must credit them with beginning and obtaining the financing for it. This is not to denigrate their efforts. Arthur Willis, the project director, and Dean Charles O. Galvin, Chairman of the Special Committee on Substantive Tax Reform, have given unstintingly of their time, and the harassment which they describe in the book has surely contributed to what I believe is an incomplete job at this point. So whatever criticism I offer should not be read as a failure to recognize the value of the services rendered by them and their committee.

Perhaps one should question from the outset what is meant by "substantive tax reform." It appears from the history of the project, written by Dean Charles O. Galvin, that this phrase was intended to distinguish a reform involving broad and fundamental changes in tax policy from the great volume of studies and recommendations involving technical and relatively narrow aspects of the tax law on which tax lawyers, over the years, have done an admirable job. The resolution of the Board of Governors of the American Bar Association charged the Section of Taxation with engaging in research leading towards the objectives of "establishing a fair and equitable tax system, broadening the tax base, and providing incentives for work and investment."\(^1\) Dean Galvin's summary of the history of the project would have benefitted

\(^1\) The resolution in full provided as follows:

1. The continuance of inquiry and research by appropriate committees of the Section of Taxation leading to the objectives of establishing a fair and equitable tax system, broadening the tax base, and providing incentives for work and investment, and

2. the consideration of specific measures designed to achieve the objectives in paragraph 1, which will have the effect of
immensely had he been able to inform us how this particular charge was chosen and to what extent it may have inhibited the objectivity of the study. To establish a fair and equitable tax system might in itself involve broadening the tax base. Thus, reading between the lines of the two stated objectives of "broadening the tax base" and "providing incentives for work and investment" suggests that the American Bar Association was at least as concerned with reducing the rates of tax on income as it was in providing for a fair and equitable system. This is further suggested by three of the items in the second part of the resolution of the American Bar Association, where several measures are suggested as means of achieving the objectives listed in the first portion of the resolution. These are providing for a maximum rate of forty percent, "ameliorating or eliminating the double taxation of corporate income," and "establishing . . . a rate structure . . . [for] corporate incomes not in excess of the maximum rate on individual incomes."

The project began with high hopes that it would demonstrate an important role for lawyers to play in a multi-disciplinary approach to tax reform. To what had long been considered the province primarily of economists, the Section of Taxation ambitiously hoped to make a substantial contribution. At the annual meeting of the Section of Taxation in 1969, the report of the Chairman of the Section expressed great concern with the limited role that the American Bar Association had been able to play in tax reform because of the organizational structure of the Association. Thus, the interest of tax lawyers in breaking away from their role as technicians and advisers on little bits and pieces of the tax law is growing. But the recently published study raises some doubts as to whether lawyers will be able to shed their roles as technicians,
and advocates for special interests, and move into the field of making policy judgments on broad-based questions about subjects where they do in fact have a quality of experience unmatched by any other experts dealing with the subject.

This doubt is raised by the contents of this study which appear to be almost entirely the work of economists employed by the project. The major work of the project appears to be that done by Attiat F. and David J. Ott, both economists, who have written the bulk of the published material and who may have done an even larger portion of the actual work of the project. The Otts’ contribution consists of a study of the first-order revenue effects of approximately nineteen possible changes in the federal income tax law. A first-order revenue effect is simply the revenue gain or loss estimated to result from a particular change in the law. These revenue estimates are done routinely by the Treasury Department upon request by Congress. Nevertheless, the Otts describe their study as a pioneering one because of the fact that they estimated not only the aggregate amount of excluded income as a result of certain provisions now in the law, but also the distribution of the aggregate of excluded income among adjusted gross income classes. To do this, they used a variety of statistical methods and the mathematics of probability. The validity of what they have done in this regard is beyond my ability to evaluate, and I believe that most lawyers will find themselves in the same position. This simply underlines the fact that this is largely a study undertaken by economists and to say that this is a multi-disciplinary study in its present state overstates the contribution of the lawyers.

With respect to the claim that this is a pioneering approach to the analysis of first-order revenue effects, I can only comment that revenue estimates will frequently be divided by adjusted gross income classes in treasury reports prepared at the direction of congressional committees. Thus, the Treasury Department appears to be analyzing both the aggregate and distributional effects of imputing presently excluded income. I do not mean to imply that scholars should rely on the Treasury Department for all their data. Clearly the studies of the Treasury Department do not always provide the particular information scholars wish to have. Further, there is no reason why scholars should take on faith the validity of the assumptions and premises and statistical analyses that the Treasury
Department uses in determining revenue effects. Thus, private studies of this type seem valuable.

But where is the lawyer to participate? Lawyers began this study, obtained the financing for it, and employed the staff. They also suggested certain changes in the tax law which might be studied. But these seem minimal contributions, and if lawyers are to assume a substantial role in broad and major tax reforms, they will have to view their participation in this sort of project as a beginning and not as an end.

The failing of the lawyers is in part their eschewing any role in making policy judgments about tax reform based on the findings of the economists. When the Treasury Department studies revenue effects of particular changes in the tax law, Congress must then come to grips with the policy question of whether the law should be changed. At this point, advocates for both change and the status quo begin to urge on Congress the second and third-order effects of the changes proposed. Lawyers participate with gusto and competence in this advocacy. Thus, the elimination of favorable treatment for capital gains would evoke a flood of objections which would largely ignore the revenue implications and address themselves to the harm to the economy, the locking in of capital to existing investments, the harm in reducing the liquidity of investments, etc. Advocates for change might point to such things as the increase in dividend pay-outs by corporations, and a possible increase thereby in consumption expenditures. Thus, the second and third-order effects of the revenue changes would be carefully weighed against first-order effects in the political arena when it came time to make judgments about the suggested changes. The study barely touched upon the second and third-order effects. This is understandable because of the limited financing available. However, the project recently has obtained new backing, and it can be hoped that it will devote more research to the economic activities of taxpayers resulting from changes in the law, and then refine the first-order revenue effects to fit the resulting model.

In a multi-disciplinary study of tax policy, the lawyers could function most effectively if they would not disavow their role as policy makers. In Congress they frequently assume this position, the Section of Taxation has frequently expressed the desire to do so, and it is puzzling that the Committee on Substantive Tax Reform has gone out of its way, in earlier statements as well as in the recently published study, to disclaim any judgment role in setting tax
policy. With the data now available from the economists, the Committee should move forward in evaluating the results and making recommendations for a position on broad-based tax reform. Admittedly, the study is not complete enough for hardened positions to be taken, but tentative judgments could be made and in this way a dialogue could be commenced which would be useful in continuing the project with the additional funds now available.

It does appear that the lawyers in the project played a role at the beginning of the study in determining what changes in the tax law should be studied. This was a necessary task and one which the lawyers were well equipped to play. But, in this undertaking, the lawyers have fallen short of the quality of work which one expects from the Section of Taxation. As the Director of the project, Arthur Willis, explains in chapter two, the lawyers are better equipped than the economists to evaluate the practicalities of a particular change. Mr. Willis points out that economists are accustomed to dealing with masses of data, whereas the lawyers experience changes in the tax system from the viewpoint of individual taxpayers. The ensuing dialogue between the economists and the lawyers, Mr. Willis says, "may enable them to agree whether, on balance, the proposal should be advocated (perhaps with modifications) or must be dropped as impractical." This does appear to be a valid commentary on the respective roles which economists and lawyers can play in a multi-disciplinary study of tax reform. However, lawyers must train themselves to see the viewpoint of the individual taxpayers who may never see a tax lawyer and those too poor to have a tax obligation. This group comprises by far the largest number of people in our society and lawyers have little or no experience with them. Their experience is with larger individual taxpayers and corporate taxpayers. If the dialogue is carried on between economists on the one hand and lawyers constrained by their own practical experience with large clients, it may totally fail to reach an equitable solution for the tax law. Louis Eisenstein's gloomy assessment of the tax bar as "a strange excuse for great expectations" in the field of tax reform would then seem uncomfortably close to the truth.²

An example of this possibility is put in sharp focus by the published studies. One of the changes studied by the project was the

effect of imputing rent on owner-occupied homes. From the comments of the Otts, as well as the special study by Robert W. Tenny, it is apparent that a good deal of time and effort was devoted to making accurate estimates of the amounts of imputed rent in each adjusted gross income class. A lawyer whose experience has been with corporate clients, and relatively sophisticated individual taxpayers, might well accept this change in the law as feasible. He might view it as unpopular but worth studying because of the desire to achieve fairness or equity on a horizontal level. However, a lawyer placing himself in the situation of the many unsophisticated taxpayers who may own low-value homes would at once perceive the political impracticality of persuading the bulk of the American public to accept this type of imputed income as real taxable income. Not only would there be vast difficulties in estimating the income involved, but it seems fairly predictable that to attempt this change in the law would jeopardize the entire self-enforcement system. Just as taxpayers tend to ignore their gambling winnings as income not appropriate for the tax to reach, it seems probable that most taxpayers would balk at paying a tax on the imputed rent of owner-occupied houses. They would no doubt protest by simply failing to report this income or greatly underestimating it. Thus, to enforce such a law would involve vast administrative complexities and an extremely expensive enforcement system. With the limited funds that were available this is one place where the lawyers should have said to the economists that the project should ignore such income, no matter how appealing it might be to the economists as a source of revenue and equity.

On the other hand, a glaring omission from the changes in the tax law that were studied was the excess of percentage depletion over cost depletion. It seems highly unlikely that the economists would not have wanted to include this item when attempting to broaden the tax base. One can only conclude that the lawyers, in their dialogue with the economists, persuaded them that a change of this type should be dropped as impractical. Once again, proceeding from the experience of representing corporate clients and large and sophisticated taxpayers, this conclusion might be understandable. A proposal to change to cost depletion would provoke a storm of protest in the Congress by relatively large and
special interests. Lawyers would be all too aware of this because of their experience with their clients. But a lawyer considering the reaction of individual small taxpayers might well conclude that they would approve of such a change. Since they form a majority of the voting public, it seems quite possible that such a change in the tax law could be viewed as a practical one when broad and fundamental changes in tax policy are being reviewed.

On the positive side, several studies were of particular interest. The project considered four different methods of revising the present taxation of corporate income and dividends in order to carry out the charge of the American Bar Association to study ways of ameliorating or eliminating the double taxation of corporate income. Although this concept of double taxation is a shibboleth common to lawyers who have given no thought to the shifting of the burden of the income tax by corporations, the comparison of the different methods was of interest and should be useful in carrying on a continuing dialogue about the desirability of making a fundamental change in this vital area of the tax law.

The study was at its best when it approached alternative negative income tax plans and compared not only the cost of these plans but the efficiency in raising families from poverty levels to income levels above the poverty line. If the assumptions on which the studies proceeded were valid, and the costs and efficiencies relatively accurate, the study could be quite useful in establishing the best approach to a negative income tax. Again, however, the validity of these studies is beyond my understanding, given the meager explanation of method contained in this book.

Another portion of the study which appears to hold promise for future usefulness was the correlation of income tax return statistics with other statistical information provided by the federal government, being primarily the Federal Reserve Board’s survey of financial characteristics of consumers and the Bureau of Labor Statistics’ survey of consumer expenditures. Since tax returns are not filed on a family basis, while the other government statistics are accumulated on a family basis, it was necessary for the project to devote substantial effort to reconciling this data. Furthermore, the tax return information is incomplete in not providing data with respect to non-filers. The study that the project made to incorporate into its statistics the information with respect to non-
filers would also seem to be useful, providing the methodology yields a relatively accurate result.

For the future, I hope that the Section of Taxation can broaden its horizons and objectives so that it can play a more important role in this type of study and in the setting of tax policy. I would make two suggestions for the Section's consideration, both of which could be carried on as a continuation of this substantive tax reform project. The Section now has a Special Committee on Substantive Tax Reform and there appears no reason why this committee could not continue to function and provide continuity to the project which has just been published.

First, the Committee should form recommendations as to broad and fundamental tax policies and submit these to the Section for comment and debate. From this I would hope that lawyers throughout the country would ultimately become better informed about the nature of an efficient and fair tax system and become effective advocates for improving our system.

Second, and perhaps most important, the Special Committee on Substantive Tax Reform should turn its attention to practical ways of achieving a transition from the present tax system to what it would view as a better system. We know that Canada’s Royal Commission on Taxation has performed a monumental task in restudying the entire Canadian system and proposing a major overhaul of that system. Yet it has not been adopted and the problems involved in making such sweeping changes in a tax law may be more than can be overcome in a political arena. Whenever a tax law is changed, there is some redistribution of the burden of taxation. Some individuals pay more and others pay less. It is inevitable that this fact will cause distortions in the economy and substantial protests from the taxpayers adversely affected. Even those who are benefitted will frequently object strenuously. A good example of this in recent times is the loud objections voiced by many segments of American business to President Kennedy's proposal for an investment credit. Once adopted, however, it became quite popular and businessmen now argue strenuously that it should not be removed. Thus, changes do create objections from substantial numbers of taxpayers and lines of economic competition that have been drawn under an existing statute must be redrawn whenever the tax law affects that competitive posture.
One possible method of transition which holds promise can be found in the tax reform proposals submitted by the Treasury Department to President Johnson in December, 1968. These proposals, under consideration by the House Ways and Means Committee during the first half of 1969, include a so-called minimum income tax. Obviously, a minimum income tax involves a redefinition of the taxable base. The redefinition of the taxable base must necessarily broaden the taxable base from what the Internal Revenue Code provides for most taxpayers. As it stands in the Treasury proposal, the minimum tax would not affect many taxpayers. The great majority of them would continue to pay on the limited tax base with the higher tax rates. It is apparent that if the rate structures applied to the minimum tax base and to the conventional tax base are gradually changed so that the minimum tax rates become greater and the conventional tax rates are reduced, the minimum tax would apply to more and more taxpayers. This could provide the means by which a gradual shift, over a period of years, could be made from our present tax system to a substantially reformed tax system containing a much broadened tax base. A gradual shift of this sort would provide ample opportunity for the competitive economic lines to be redrawn and adjusted to the new tax system and would not affect large numbers of taxpayers in any one year. I suggest that this is one of the areas which could be fruitfully studied if the project of the Special Committee on Substantive Tax Reform were to be continued.

In any event, this pilot project marks a new beginning of sorts in the attempts of lawyers and economists to work together effectively in the area of public finance. One cannot be overly critical of the failures of a beginning. Rather, one can be optimistic that we can learn from this and find more meaningful ways for lawyers to contribute to these broad policy questions. Their interest need not be transient; their expertise need not be superficial. Thus, this publication should be taken as an encouraging sign that lawyers are desirous of using their talents in this endeavor and are willing to devote their time, energy and money in finding ways to do so.

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