

POINT & COUNTERPOINT: TAX POLICY AND POLITICS

INTRODUCTION: We as a nation have just finished a presidential campaign in which tax proposals received prominent attention. Both candidates' proposals were criticized for representing a response to interest group pressure rather than disinterested policy. In a bit of a departure from the usual Point/Counterpoint format, we have asked four tax professors—Jim Maule of Villanova, Alan Gunn of Notre Dame, George Yin of University of Virginia, and Marty McMahon of University of Florida—to step back from the immediate political fray and to consider more generally the tension between tax and politics. To focus their comments, we have asked each to respond to the following proposition:

"Political concerns, rather than tax policy concerns, now lie at the root of tax legislation."

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People like to complain about taxes. They complain about having to pay them. They complain that the rules are too complex. They complain that the law makes no sense. They complain that their tax burden exceeds everyone else's. These are not the bleatings of irrational idealists. They are the cries of tax practitioners, tax students, tax professors, and taxpayers.

At one time, the complexity and inequity in the tax law were attributed to tax policy. Now the proliferation of tax expenditures, exceptions to exceptions, targeted credits, specialized deductions, cascading definitions, bubbled tax rates, and the swamping of the Code with disguised appropriations provisions suggests that much of the morass that is the tax law is the product of electoral politics. Hence the proposition is one with which I whole-heartedly agree.

Though I agree with the proposition, I hesitate to cast blame. Fixing blame doesn't provide a solution. The situation is not the fault of any one individual, any one committee, any one organization, any one political

party, or any particular segment of the public. It is, instead, the product of a cultural breakdown in the problem-solving process, an erosion of methodical, structured, organized, and razor-sharp precision thinking, and an abandonment of sweeping perspectives in favor of soundbite-sized, narrow tax tidbits. Equally, it is a tribute to diminished societal common sense and a widening of the chasm between practical and theoretical.

Tax policy concerns differ from political policy concerns. Tax policy is a question of ascertaining the most appropriate manner to raise revenue. To some, it also involves the matter of shifting resources from one sector of society to another. Tax policy requires an examination of progressivity, horizontal and vertical equity, administrability, and economic efficiency. Political policy is a question of acquiring votes by inserting spending provisions in revenue legislation in the form of credits and deductions targeted to identified segments of the electorate.

Although both tax policy and political policy involve issues of civic responsibility, political policy concerns contaminate the tax law with partisanship and its consequences. It is one thing to engage in partisan debate concerning the level

of tax rates. In that instance, the outcome is simply a change in percentage rates. It does not cause the creation of a tax-favored class whose members are identified not by income level but by social behavior. It is another thing to hide government expenditures favoring targeted groups in the tax code. That is a political ploy that makes it less likely citizens can identify targeted spending.

In recent years it has become common practice for the Congress, no matter which political party is in control and no matter who lives 16 blocks up Pennsylvania Avenue, to stuff the tax law with all sorts of "goodies" designed to entice voters to select one candidate over another, or as "rewards" to fulfill campaign promises to some extent. Too often, the provisions are hastily drafted, receive cursory review, undergo chopping and interlineation, conflict with other Code sections, and require the impossible compliance and record-keeping efforts by taxpayers and their advisors. Lost in this ad hoc, me-first process is the long-lost art of stepping back and looking at what the big picture would be if the provision were enacted and evaluating the impact of the provision on the fabric of the tax law. New terms are invented. Terms that had one definition are given a second, and different, definition. Patterns of Code drafting that worked well are abandoned, not so much intentionally as through inadvertence and ignorance of their existence. As a result of this fragmented approach to tax legislation, there no longer is a coherent, consistent, and sensibly structured tax policy reflecting itself in the Code. Is it any wonder that the Code now fills 2,840 pages? Why are there several different definitions of "small business"? Why are some numbers adjusted for inflation and others left alone? Why are there dozens of

uncoordinated provisions each trumpeted by its sponsors as the tide-turning solution to the challenge of financing and improving education?

Because many taxpayers generally dislike the shifting of resources by the government, at least when the shifting isn't limited to other people's resources, and resist raising revenue to fund "government services" that are activities in which they feel the government ought not be involved, most legislatures would be voted out if they enacted or increased taxes straight up. So taxes get packaged, re-labeled, irradiated, sprayed with quick-freshener, bundled, and hyped. Magically, a tax increase is a tax cut. A spending increase is a tax cut. A tax cut is a disguised tax increase. A tax on one group is described as a tax on some other group. Superficially, everyone ends up concluding their taxes are being cut. Of course, tax revenue increases. Divide and conquer.

The few who really see through all of this either learn the "game" and use it for the benefit of their clients or learn the "game" and try to outlaw it through their teaching, public service activities, and other civic endeavors. What emerges from this political double-speak is a tax code that encourages the marketing of "products" designed to bring taxpayers within one or more of the hundreds of targeted tax breaks even though they don't otherwise qualify.

Taxpayers are induced to engage in activities in which they would not otherwise participate, to do business in ways they would not otherwise operate, and to manufacture transactions that border on the abusive, fraudulent, and even criminal.

None of this makes good public policy, let alone good tax policy. The Treasury becomes saddled with the responsibility of bailing out the Congress by resolving the problems created by the omissions, ambiguities, inconsistencies, and nonsensical language peppering the Code. Is it any wonder that there now are 46,000 pages of tax rules and regulations?

To reverse the trend requires wide-

spread public acknowledgment that it is time to say goodbye, coherently, carefully, gracefully, elegantly, compassionately, and sensibly, to the present tax world. A tax system for the 21st century is needed. At the moment, the specifics of that new system are not as important as finding a strategy that sensitizes the electorate to the importance of a coherent revenue policy. Genuine tax reform must find its way into the public limelight and thus onto the politicians' radar screens. Recent polls suggest that most citizens don't care much about the issue. Gasoline and heating oil price increases get more attention and cause more publicized pain than does the prospect of 435 new credits, 500 additional forms, and 250-page tax returns. Until the media makes tax reform its darling, the policy of politics will continue to overshadow the tax legislative process and suffocate attempts to consider issues of equity, administrability, and economic efficiency. A daunting task awaits those who wish to engage citizens and politicians in a thoughtful reconsideration and thorough analysis of the tax law when existing law and its deficiencies cannot be encapsulated in a sound-bite, wrapped into a generalization, or packaged in simplistic buzz-words. Here's hoping it happens.

ALAN GUNN

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The tax system has always reflected both policy and politics, but since 1986 the balance has shifted sharply toward politics. This statement can't be proven—one person's obvious political giveaway is another's sound policy. (I have heard an energetic defense of the poultry poop tax credit—not on the merits, but on the ground that, as an "environmental" measure, it must be good.) Without getting into the merits of the many subsidies that now litter the Code, I shall argue that politics now dominates policy by pointing to several features of the Code that can be explained only on crass political grounds.

First, the rate structure. A decent tax system would tell people in a straightforward way how much more tax they would owe if they earned an additional hundred dollars. Ours doesn't: the rates of section one are only a starting point. Itemized deductions are "phased out" (by a provision that in most cases operates without regard to the amount of the taxpayer's itemized deductions); additional income will raise many people's taxes (sometimes by more than the amount of the additional income) because their personal exemptions are phased out; and a host of other phaseouts make nonsense of the rates so simply set forth in section one.

Second, the alternative minimum tax. Advertised as a measure to limit the use of loopholes, this tax now operates principally as a tax on those with many dependents and with lots of itemized deductions. With the repeal of the AMT rule for charitable contributions of appreciated property, this tax has become a sham, falling most heavily on those with heavy expenses that, for no good reason, are disallowed for AMT purposes.

Third, complexity. As just one example, consider the many tax-favored ways of "retirement" saving. Congress seems unable to resist adding new vehicles and tinkering with the old ones each year, while taxpayers are often unable to cope with the old ones. A few years ago, the Service checked a large number of universities for compliance with the rules of section 403(b) and found that none had gotten it right, yet 403(b) plans are about as simple as retirement savings vehicles go.

Finally, consider a measure that passed Congress almost unanimously (always a bad sign): the supposed "shift in the burden of proof" to the Government in tax cases. As the burden of proof shifts only for taxpayers who have already met it, this legislation is a fraud, adopted after an absurd set of hearings, the only apparent purpose of which was to encourage voters to blame their difficulties with the tax law on the

Service rather than on the legislators who created that law.

Is there any good news? Well, real estate tax shelters were pretty much done in 1986. Since then, we've had reams of new statutes, all adding to the complexity of the Code, none seriously attempting any "reform" except in narrow and highly technical areas. It's been a bad 14 years for tax policy.

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I disagree with this proposition because it erroneously suggests that there has been a sea change in the factors influencing tax legislation. Politics and policy have always played significant roles in the enactment of tax legislation and that fact continues to be true today. To be sure, the precise mix of the two elements varies somewhat from period to period, and tax policy considerations do not seem to be as strong an influence now as they were in the mid-1980's. But I am not persuaded that what we are seeing today represents any dramatic change from either that period or earlier times.

In contending that we have experienced a sharp shift towards politics since 1986, Professor Gunn raises several examples, which, I think, tend to support my view. The AMT features he criticizes as having little policy justification—the nondeductibility of itemized deductions and personal exemptions—came into the law in 1986 (or in a technical correction shortly thereafter), his peak year for good policy. The 1986 Act also included various phaseouts that obfuscated the true tax rate structure. Conversely, the key point regarding the burden of proof legislation is that it turned out to be, as Professor Gunn states, a "fraud." In other words, policy concerns ultimately prevailed over crass politics to prevent any meaningful change in that area.

Personalities certainly play a role in the relative importance of policy

and politics but so do many other factors. The end of bracket creep and the large budget deficits persuaded lawmakers during the mid-1980's to raise taxes without raising rates (a political calculation). Many of the resulting base broadeners therefore served political goals as well as sound policy objectives. Later, the budgetary situation (and the public antipathy towards increased direct government spending) has forced lawmakers to use the tax code more for their spending initiatives. These changes seem part of the normal cycle of events influencing tax legislation.

Will policy make a rebound in the near future? A gloomy assessment is that the political deadlock will not permit it. Any tax legislation will be a product of naked political trades—one from column "D" and one from column "R"—with no sensible pattern from a policy standpoint. A much more optimistic view is that the competing political agendas will neutralize themselves, thus leaving the field wide open to good policy. The most likely scenario, barring any significant change in the economy, is that the stalemate will prevent major legislation altogether: we will see neither large tax cuts nor substantial spending increases (either directly or through the tax code), with the default being a reduction in the national debt. Could be worse.

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When I reflect on the nature of tax legislation since 1987, I often am tempted to succumb to the dreary conclusion that "tax policy" is dead. In the past few years neither the Republican Congress nor the Clinton administration has advanced proposals that I would consider to represent sound tax policy. Much of the legislation that has been enacted has undone the principles underlying the Tax Reform Act of 1986. The basic

theme of the 1986 Act was to lower the rates while expanding the base to be more comprehensive. To be sure, the 1986 Act contained some political gimmickery, such as rate bubbles created by the section 67 floor on miscellaneous itemized deductions, the section 68 haircut on certain other itemized deductions, and the section 151(e) phase-out of personal exemptions. Any valid policy goals of those provisions largely could have been achieved through a greater number of statutory rate brackets. To do so, however, was not politically palatable, even when the top rates were increased in 1990 and again in 1993.

The tax legislative process now frequently appears to be little more than electoral politics played out in the pages of the Internal Revenue Code. Discussion and debate seem to focus more on the distributional impact of changes in base and additional tax credits than on the structural coherence of new legislation. General rules are disappearing under a welter of special rules. "Targeted tax cuts" wreak havoc with the tax system, adding inordinate complexity and rendering the determination of effective marginal tax rates an unsolvable mystery. If distribution of tax burdens across income classes is the real concern, it can, and should, be resolved primarily by changes in the rate schedule in section 1. But apart from the changes at the top end in 1990 and 1993, that has not been the route chosen.

Consider the new credits enacted in the past decade and a half. On the business side, there are the section 1396 empowerment zone credit, the section 44 disabled access credit, the section 43 enhanced oil recovery credit, and the section 51A welfare-to-work credit, not to mention significant tinkering with the section 41 increased research expenditures credit and the section 51 targeted jobs credit, renamed as the work opportunity credit. On the individual side, in the past six years alone we've added the section 24 child credit, the sec-

tion 23 credit for adoption expenses, the section 25A Hope scholarship and lifetime learning credits, and the section 1400C credit for District of Columbia home-buyers. These individual credits are piled on top of, or overlap with, the pre-existing credits under section 21 for child care expenses, the section 22 credit for elderly and disabled taxpayers, the section 25 home mortgage credit, and the much-modified, ever-increasingly complex section 32 EIC, a provision that not even the proverbial rocket scientist easily can understand and apply correctly, but which applies to those least able either to read rules themselves or to afford competent tax advice, and which, to boot, creates its own egregious rate bubble. (The section 25A education tax credits, furthermore, are but part of another web of poorly coordinated tax expenditures for education including Education IRAs and the section 135 exemption for U.S. Savings bond interest used to pay education expenses.) Much of this tangle of credits was brought to us by a Congress that paid lip service to simplicity while dedicated to cutting taxes in virtually any way possible, and an administration dedicated to social spending. Perhaps both Congress and the administration believed in the merits of their proposals, but the tenor of political campaigns over the past decade surely justifies some skepticism about the motives of both sides. When the administration dressed up its spending programs as tax cuts to get them through Congress, the inevitable result was chaos in the pages of the tax Code.

Finally, there is the capital gains saga, the never-ending story. The problem of how to tax, or not to tax,

capital gains has a long lineage. As long as the rates are positive there will be a hue and cry from some quarter that one, or another, or all types of investment need, or are entitled to, some preference for one reason or another. There is nothing better than the capital gains debate, however, to illustrate that the Congress does not care carefully to analyze the actually anticipated economic effects of the tax rules or changes in the tax rules but would rather postulate effects that justify the particular politician's preconceived notion of who deserves a tax reduction or who should bear the burden of a tax increase. There are few provisions that compare to section 1(h), in all its glory, to inspire the question, "What policy?"

Reasonable people may differ on (1) the proper role of government in our society, (2) whether nonrevenue goals should be pursued through the tax system, and (3) who should benefit from government programs implemented through the tax system. All of the credits noted above, as well as the capital gains preference, are examples of this tension. These rules present tremendous complexity, but whenever government acts to deal with a perceived problem, someone gets overwhelmed with detail. Who gets overwhelmed is a matter of how government chooses to act. But as far as taxation is concerned, it's hard enough just to pick the right base, measure income if that is the base, choose the right taxable unit, and figure out how to deal with business entities, sophisticated financial instruments, and international transactions. These are crucial tax policy issues that, with the possible exception of the proper treatment of married couples—I refuse to use the

"m----- p-----" term because it's a loaded term designed to preordain the resolution—are not being adequately and comprehensively addressed at the legislative level, although there are occasional instances of legislative problem solving, such as the section 357(c) "fix" last year. But no one seems to care about the problem of the AMT trap disallowing a deduction for plaintiff's attorney's fees in taxable personal injury cases. Now that's a tax policy question. Thus it is easy to get frustrated with the never-ending parade of tax expenditure proposals from time to time and to conclude that there is no tax policy anymore, just politics.

On the other hand, many of the credits, for example, as well as other unenacted proposals, do reflect some policy choice, not necessarily tax policy, but some type of government policy, and it's just the packaging that is political. (Let us not forget that, in order to get it passed, Social Security originally was politically packaged as akin to saving through insurance, rather than acknowledged as an intergenerational income transfer program.) Any of us may or may not agree with any particular policy proposal, but that doesn't necessarily mean it's not some sort of policy proposal, even if it's environmental policy implemented through the tax system as, for example, tax-free transit passes. And we may disagree with the efficacy of particular provisions, such as the capital gains preference, but that doesn't necessarily mean that there was no policy, just politics. Maybe there was, maybe there wasn't. Resolving this last issue is what public choice theory of the legislative process is all about. ■