INTRODUCTION: In 2005, the President’s Advisory Panel on Federal Tax Reform issued its final report and recommended a number of options to make the Code “simpler, fairer, and more conducive to economic growth” while describing the state of the current tax system as “unacceptable.” For tax year 2005, the Form 1040 instruction booklet was 141 pages long—more than 2 1/2 times the number of pages in the year before the last major tax reform effort in 1986. Since 1986, numerous panels, 15,000 tax changes, and innumerable other pieces of legislation have been introduced to recommend changes to “fix” the tax code. Jack Cummings suggests that the time is right for tax reform. He provides a macro-guide to tax reform and proposes a number of incremental steps to tax efficiency.

The NEWSQUARTERLY encourages readers to respond to this essay by submitting a Counterpoint or other comments, which may be published in a subsequent issue.—Christopher M. Pietruszkiewicz, LSU Law Center, Baton Rouge, LA

My point is a simple one aimed personally at each reader: you must get involved with protecting your federal tax system because you can’t leave it to the “experts.” If you don’t, you may see the baby (near 100 years of experience with an income tax) thrown out with the bath water (aspects of the Code that are legitimately disliked).

CHANGE IS IN THE AIR

Talk of “tax reform” blooms regularly like the flowers in May, but this time it could be for real. The reason is money—the only thing that really moves tax law changes.

First, the Fisc is in crisis. A good indicator is that our new Treasury Secretary used his first public outing to call for reducing entitlement spending. This is fairly obviously the only way to semi-balance the budget without raising taxes. In broad brush strokes, the Secretary undoubtedly sees the choices as either (1) moving to a European model where the federal government has broader social programs and higher taxes, or (2) the administration’s preferred model where the government has limited social programs and lower taxes, at least on capital. We know which one the Secretary picks.

Another money issue is the coming end of the limited-term tax cuts enacted around the turn of the century; this issue is intertwined with the AMT. If the cuts are extended and the AMT remains unchanged, then the AMT may supply some or much of the revenue shortfall, but with considerable anguish to taxpayers. If the cuts are not extended, then there will be considerable anguish, even if the AMT is changed. Something will happen, one way or the other.

You must get involved with protecting your federal tax system because you can’t leave it to the “experts.”

The third money issue is the hydraulic pressure on tax reduction caused by business viewing tax cost as a “profit center.” The influence of business on tax policy is nothing new, but at some point it must be recognized that one can agree in theory that a zero capital tax rate would be better for the business climate, without concluding that only consumers should pay tax.

WHAT CHANGE?

Once the reader’s attention has been captured by the money issues, he or she must roll up the sleeves and wade into the melee of “policies.” Your aim should be to separate the wheat from the chaff, the self-serving from the true, and the simple from the needlessly complex.

You will quickly confront the taxation of capital issue, the consumption tax issue, the flat tax issue, the savings and investment issue, and the progressive tax issue. Here is a guide.

“Taxing capital” does not really refer to taxing capital, as in a property tax. It refers to taxing the return to capital, which consumption tax advocates view as a bad thing. The reason it is a bad thing is that it is thought to make capital owners grumpy, and you just can’t have grumpy capital owners because they may pick up their marbles and go elsewhere to play, which means less jobs. Jobs are the selling point here, because jobs are the mother’s milk of politics, votes, and—most importantly—funding those consumption taxes that the anti-capital-tax folk want to shift to.

The technical term for making capital owners grumpy is “impeding savings and investment.” Capital owners are made happy by savings (by someone else) because it enables them to borrow cheap and buy plant and equipment (investment), which leads to jobs. The only problem is that there is no way to insure that the plant and equipment and jobs are here. The massive repatriations under section 965 have revealed, if we did not already know, that our best “made in America” brand names do huge business abroad, and would just as soon keep much of their earnings there, absent some special carrot to bring them home.
Flat tax is usually a version of a consumption tax, meaning principally not a tax on capital. Its other signal feature is non-progressivity, which should be viewed as an entirely separate issue from capital versus consumption taxes. If we could get the income tax “right” (broaden the base and lower the rate), we probably would not be so worried about progressivity.

ONE HUNDRED YEARS OF EXPERIENCE

One of the most knowledgeable tax persons I know recently told me that he viewed the authors of the 1954 Code as geniuses. I agree.

The Code is a marvelous record of human brilliance and best intentions, stymied at times by human nature, the nature that Russell Long said prompts us to say “Don’t tax you, don’t tax me, tax the man behind the tree.” Very smart people have labored long and hard to make and keep the code logical and consistent. They have not always been successful. That is not, however, a reason to throw out the Code. It is a reason to retain what is fundamentally right about it and prune the underbrush every few years.

There is no reason to think that a newly created VAT, for instance, will be any simpler or less subject to politics than the income tax has been. There is reason to think that a newly created VAT would be more subject to influence by those who study it and spend the most money trying to influence its drafting and administration.

It is widely agreed that the Tax Reform Act of 1986 was a great achievement of “good government.” The key was broadening the income tax base and lowering the rate. No thoughtful observer rejects the wisdom of such an approach to any tax system.

A PROPOSAL

For discussion purposes I propose that an unbiased, somewhat knowledgeable, observer would fairly conclude that in lieu of “fundamental tax reform,” the following steps should be taken:

- Once again, broaden the income tax base and lower the rates;
- Eliminate the AMT, and incorporate any of its “policies” deemed worthwhile (other than insuring that Congress will not have a list of 100 millionaires who paid no tax) in the regular tax sections affected;
- Establish better collection methods, such as withholding on passive income;
- Properly fund the IRS and let it do its job, which is to collect taxes due; and
- Link reduction of tax incentives for health care with fundamental health care reform outside the Code.

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