INTERVIEW WITH GEORGE K. YIN

by Jasper L. Cummings, Jr. and Alan J.J. Swirski, Washington, DC

INTRODUCTION: George Yin has been Chief of Staff of the Joint Committee on Taxation since early 2003. He left the staff on November 18, 2005 to return to the University of Virginia School of Law where he will be nominated to become the inaugural Edwin S. Cohen Distinguished Professor of Law and Taxation.

GEORGE YIN

Q You were tax counsel to the Senate Finance Committee from 1983 to 1985. How does the tax writing process today compare with the process during your earlier tenure?

A There have been a number of differences in that twenty-year period. There certainly has been an increase in activity. As one small measure of that, the Joint Committee on Taxation in 2003 received almost 5,000 requests for revenue estimates of tax legislative proposals, a roughly ten-fold increase over the number of requests received twenty years ago. I suspect that if you actually counted the number of tax bills filed, or examined other indicators of legislative activity, there would be a comparable increase. All of this is in part attributable to an increasingly complicated society with more problems, and therefore more proposals for tax legislative changes to solve those problems. Furthermore, as the law gets more complex, it feeds on itself so that the more-complicated law generates more proposals for change. So there definitely has been an increase in overall activity. Interestingly, since the number of members of Congress has remained constant during this period, it may mean that the members now devote less time to each proposal than they did twenty years ago.

Another very important change is the limited term of the Chairs of the tax-writing Committees. I think that every member of Congress would tell you that there is a very dramatic and significant difference between simply being a senior member of a committee and being the Chair of the committee. The Chair has a tremendous amount of responsibility in terms of overseeing the overall agenda. So if in fact, as we have seen in recent years, there is a greater turnover in the identity of the Chair, because of term limits or other reasons, that change no doubt has had a significant impact on this process. Moreover, when Chairs turn over, their staffs typically turn over as well, and that similarly has an important effect. In general, there are also greater numbers of staff involved in the tax legislative process, both at the committee level and also for each of the individual members of the committee.

One other important fact is that staff salaries continue to be less and less competitive with private sector salaries. This has occurred in part because of the caps that are placed on staff salaries due to the caps on Congressional salaries. This increasing salary differential presumably will mean a greater and greater difference over time between the quality of the people on the outside versus the people working for the Congress.

I will mention just one last difference, which I am sure is familiar to all of your readers. Twenty years ago, I would come back from a day of many meetings and see on my desk a stack of fifty or so pink slips containing telephone messages. Being a fairly conscientious sort, I would go through them and try to figure out which ones I could and should respond to as quickly as possible. But today, of course, I come back from the same busy day of meetings and have 200 emails in my inbox, with each of the people who sent those messages thinking that I am aware of, and working on, their particular problem. All of a sudden, it becomes that much more important for me to respond to each of those messages as quickly as I can, if only to say, "I haven't looked at your problem yet." Thanks to our new technology, the pace and expectations of the job are completely different. Obviously, we also have blackberries, faxes, cells phones, laptops, and the rest, to help ensure that one is always on the job. I can only imagine how the practice of law has similarly changed over the same twenty-year period.

Q You were involved with the proposals and planning leading up to the Tax Reform Act of 1986 and wrote in 1987 on the subject of repeal of the General Utilities doctrine. You foresaw corporate efforts to escape the repeal by using passthroughs. Did you or others foresee that the repeal could lead to "corporate tax shelters" as some have come to call them, and do you believe it has contributed to that phenomenon?

A Well, that's a new one for me. I suppose if one thinks of General Utilities repeal as an effort to make the corporate tax base more comprehensive, and tax shelters as an effort to avoid being taxed on that more-comprehensive base, then there might be a link between the two. But, that's like saying that if Congress had only repealed the income tax in 1986, there would not be any income tax shelters today. That would also be true.

I would, however, identify a different aspect of the law that might be contributing to corporate tax shelters and be worth reconsidering. I have never completely understood why corporations are fully taxed on their capital gains from investments in the stock of other companies. That seems somewhat contrary to general principles we have in the income tax system. In my review of corporate tax shelters, some number of them seem to be designed to create capital losses that would be used to offset capital gains from investments in stock in other companies. This, of course, does not justify the shelters at all. Nevertheless, if there is something fundamentally flawed in the taxation of those gains, then maybe that should be examined quite apart from the tax shelter issue.

Q You have written about corporate integration. In 2003 Congress enacted a weak version of integration in the form of a reduced tax rate on dividends. The Tax Reform Commission has proposed some additional integration. Is this a realistic possibility and in what form do you think it will come?

A Assuming that there continues to be an income tax, the corporate integration issue is most usefully thought of separately for public companies and non-public companies. For public companies, I have long advocated the idea that retaining two opportunities to tax actually makes some degree of sense and that the main thing that should be achieved is to reduce the rates of those taxes so that the overall burden in the corporate sector is not disproportionate to the burden outside of the corporate sector. Now obviously, as you suggest, Congress already took a step in that direction in 2003 by reducing the tax rate on dividends and capital gains. It would seem that the next logical step would be to consider a reduction in the corporate tax rate. This may be a viable option for public companies because even if the corporate tax rate were reduced below the top tax rate for individuals, we do not typically think of individuals using public companies as a vehicle to shelter their income. Thus, reducing the corporate tax rate (and keeping the dividend tax rate reduced) would be a viable way to achieve a form of integration for public companies. To ensure that all corporate-source income is taxed at least once, Congress would need to pair any corporate tax rate reduction with a broadening of the corporate tax base. In addition, integration does not provide any justification for reduced capital gains taxes on investments not involving corporate stock, such as real estate.

For non-public companies, you could not achieve integration in the same way. On the other hand, for non-public companies, you could do something that really would not be viable for public companies, which is to have integration through some kind of passthrough scheme. As you know, in the 1990s David Shakow and I came up with a recommendation to provide a passthrough scheme for all private firms, no matter how organized. In general, we recommended something like a liberalized Subchapter S form of passthrough taxation for private firms that have certain restrictions on their ownership structure. For all other private firms, we recommended that a passthrough result be achieved through a reformed version of Subchapter K. Importantly, private firms would no longer be allowed to use Subchapter C, which would be reserved for public companies.

Q You have thought a lot about how a consumption tax system could be designed to accommodate the working poor. To what extent are consumption taxes really just "wage taxes," and do you foresee any real likelihood of either an add on consumption tax or a consumption tax replacing the income tax?

A First, in terms of whether a consumption tax is simply a wage tax, the current literature is fairly clear that that is not the case. A "cash-flow" consumption tax (such as a qualified retirement plan, a 401(k) plan, or a "traditional" IRA) is the same as a wage tax, and they both differ from an income tax, principally in the taxation of the risk-free return on capital. An income tax taxes that return, but a consumption tax and a wage tax do not. The risk premium, however, and the potential abnormal rents from capital investments are taxed under both an income tax and a cash-flow consumption tax. In contrast, neither is taxed under a wage tax. So a cash-flow consumption tax is not the same as a wage tax. It is also not the same as an income tax. It is somewhere between the two. (A "yield-exempt" consumption tax, such as a Roth IRA, does not reach these additional returns to capital and thus is analogous to a wage tax.)

In terms of the likelihood of adopting a consumption tax in the future, I can envision some incremental changes that would move our current system, which is not a pure income tax, further in the direction of a consumption tax. I can envision two types of changes. One set of changes would be to adopt some further expansion of savings incentives as well as to allow greater expensing of capital investments. In addition, in conjunction with those changes, which presumably would result in some loss of revenue, a second set of changes would be to tax consumption more comprehensively than we do today. In the current system, we tax neither savings nor consumption fully. While consumption tax advocates might applaud the former result, there seems to be little justification for the latter. Both income tax and consumption tax advocates should be able to agree that at least consumption should be taxed comprehensively. That would be a useful first step for any tax reform.

One worry about any incremental move towards a consumption tax is the appropriate taxation of debt. At least in theory, in a proper consumption tax, increases in debt should be included in the tax base and decreases of debt should reduce it. Under current law, we do not include increases in debt in the tax base. If we continue that treatment of debt yet move closer and closer to a consumption tax base in other ways, we can quickly achieve a system that is totally irrational and would raise an insufficient amount of revenue.

Q Do you view the combination of penalty and disclosure reform that the Congress and the IRS have aimed at the more recent tax shelters as having been as effective as the 1986 legislative changes aimed at individual tax shelters, and if not what could be done better?

A I do not view the penalty and disclosure changes that have been made in recent years as having been anywhere near as effective as the 1986 changes in combating tax shelters. The 1986 changes, the principal one being enactment of the passive activity loss rule, essentially ended a whole category of shelters. I do not think anything that has been done in recent years has been anywhere near as effective as that.

In terms of what could be done, if we are serious about wanting to create constraints on tax shelter activity, obviously the 1986 experience provides a model for what further steps might be appropriate. It certainly is the case that that model has not gone overlooked by people either inside or outside of the government. The difficulty is trying to figure out what kind of rule analogous to section 469 could be adopted today. The shelters of twenty years ago, even though they were very extensive and problematic, were often of a similar type. One could then craft a rule like section 469 that in a rough way challenged that whole category of tax shelter.

In today's world, the shelters are more complicated. They do not necessarily have the same pattern and focus. Coming up with an appropriate rule to address them is difficult, to say the least. A rule that attempts to curb today's shelters is likely to be both too broad and too narrow. An alternative approach is to elaborate a bit more on the meaning of an anti-tax avoidance standard that might be available to combat a shelter after the fact. The advantage of such a course is that it wouldn't be necessary to achieve the same degree of precision as a section 469-type rule in exactly hitting only the targeted transactions. All a heightened anti-tax avoidance standard does is to say that a particular transaction is suspect and needs to be examined further by someone else, presumably by a court. Thus, the degree of precision in identifying the affected transaction upfront does not have to be as great.

As you probably know, in January 2005, the Joint Committee staff laid out an option to address tax shelters by clarifying the meaning of the economic substance doctrine in a targeted way. The proposal identifies up front five or six categories of transactions having the characteristics of tax shelters, and provides that those transactions are subject to a somewhat higher level of scrutiny by a court. The proposal does not say that any taxpayer with such a transaction will not have its tax position respected. Furthermore, it does not specify how the transaction should be taxed if the taxpayer's position is not respected. All it says is that the taxpayer is forewarned that such transactions are suspect and will deserve some higher degree of scrutiny down the road. Obviously, the hope is that the proposal would help to deter some tax shelter activity.

Q What is the status of that issuance by the Joint Committee?

A It was a set of options that we put together in response to a request from the Chairman and Ranking Member of the Senate Finance Committee. The request was to suggest options to improve tax compliance and reform tax expenditures. We put together a report with about seventy or seventy-five specific recommendations, one of which related to the tax shelter issue I just mentioned.

Q Has anyone acted on any of those recommendations in any public way?

A Well, a relatively small item has actually already been enacted into law. Others have been considered and included in bills approved by the tax-writing committees. There also have been hearings on some of the proposals. The process obviously takes a while. I assume that the menu of ideas put together by the staff will continue to be relevant to the Congress for some time to come.

Q Please describe the legislative process leading up to the 2004 JOBS Act in terms of (1) level of lobbying activity, (2) involvement of the Treasury, and (3) involvement of the IRS in technical drafting and planning for implementation.

A There was a lot of lobbying activity. In terms of how the level of activity compared to that in prior periods, my assumption is that lobbying has probably increased, although that issue could be examined empirically. One difficulty in researching this is identifying the appropriate metric to measure and compare the level of activity. Obviously, larger and more complicated bills with complex and potentially significant provisions are going to engender more private-sector interest than simpler, more straightforward bills. It would be necessary to find a prior bill that in some sense is "comparable" to the JOBS bill in order to compare the amount of lobbying activity.

Involvement of the Treasury is an interesting question. On some issues, such as a Senate Finance Committee proposal to clarify the economic substance doctrine in a comprehensive way, Treasury's influence was quite apparent. Treasury opposed the idea, as did many people in the private sector. Without any government support and with ample outside opposition, it was quite clear that that proposal was not going to be enacted into law.

On the other hand, Treasury also opposed other provisions that did make it into the law. Two examples are the repatriation proposal and the manufacturing deduction, both important components of the JOBS bill. The Treasury was strongly opposed to both, with the rumor that the President himself had been critical of the repatriation provision, yet that opposition did not deter their enactment. From that experience, one might conclude that Treasury's influence was not very great in 2004. Now whether their influence was less than what it was in

1986 or earlier times, other people are going to have to figure that out.

In terms of involvement of the IRS, it has always been somewhat of a bone of contention as to how much and how early the IRS should be involved in the legislative process. At some level, I think all who are part of the process understand the importance and the advantage of involving at an early stage those persons who will be responsible for actually carrying out the various provisions, should they be enacted into law. On the other hand, the concerns of the IRS should to some extent be represented by the policy office of the Treasury Department. Furthermore, if the legislative process is a contentious one—and aren't they all—proponents of the legislation will place a premium on minimizing the number of people involved in the process at all stages, particularly the early stages. That means that a lot of people often are cut out of the process who probably should be involved. This reality applies not just to IRS personnel, but certainly includes them.

Q We have seen an increasing number of businesses that choose to operate as S corporations. What is your view of these developments as a policy matter?

A Well, I hope it does not reflect some type of abuse that would require a major revision of Subchapter S. After a number of years of study, I am convinced that the S corporation regime is quite a sensible way to achieve a form of integration for private companies. There are certain keys to making the regime work correctly. The most important key is the limit it places on who can be an owner of an S corporation. The theory of this limit is very straightforward—as long as the owners of a passthrough are more or less in the same tax situation, a whole lot of problems that we see addressed in great detail in Subchapter K can be avoided. This is because we just do not care very much about how the various owners share the tax items of the corporation. But as soon as there is deviation from that general principle, there is the need to create something like Subchapter K, a much, much more complicated and (in my view) less desirable passthrough regime.

The neat thing about Subchapter S is that intentionally or unintentionally, it contains ownership restrictions which more or less achieve the necessary policy condition. One restriction is to prohibit tax-exempt and foreign owners or, in the case of tax-exempts, ensure that their share of the entity's income is taxable to them. The other is to prohibit corporate owners of an S corporation. The reason corporate owners are problematic is that some corporations have large pools of losses and therefore are effectively tax exempt to the extent of such losses. By eliminating these two categories of owners, we are left with S corporations whose owners are taxed pretty much alike. In that world, we can have quite a simple and straightforward method of taxing the income of the business only once.

Q Please describe the process by which the Joint Committee staff reviews large refund claims and what happens when the staff and the IRS disagree.

A Under the law, the Joint Committee has jurisdiction to review any proposed refund in excess of $2 million. The law does not specifically grant any authority to the Joint Committee beyond that. That is to say, the Joint Committee must have an opportunity to review such proposed refunds, but has no ability, for example, to stop any refund with which it may disagree. The process that the Joint Committee and the IRS carry out is a collegial one. The Service provides to the Joint Committee a file on all proposed refunds in excess of $2 million, and we try to review them expeditiously. We offer little or no comment on many of the proposed refunds. For some, we point out some error that may affect the refund in some way. In a few instances, we raise a more serious objection. It is really then up to the Service to determine whether any particular action should be taken in response to our objection. Over the years, we have maintained a very good relationship with the IRS and I believe they take our concerns seriously.

The Joint Committee's refund review jurisdiction also benefits its legislative responsibilities. The staff has a little window to observe how the tax law is being administered, and some of those observations lead to legislative proposals to change the law.

Q Are there any statistics on how often the IRS agrees or disagrees with a negative reaction by the Committee as to a particular refund?

A I am not aware of any.

Q Are you aware of any effort in Congress at any point to give the Joint Committee something more like a veto power over refund claims?

A I am not aware of anything like that, and I frankly do not think it would be a good idea. A veto power would obviously put a lot more responsibility on the work that we do and the decisions that we make. We frankly are just not set up for being a comprehensive reviewer of all large IRS refund claims. I have three attorneys who do essentially all of our refund review work. If you compare that to the hundreds or maybe thousands of people at the IRS who are processing these various claims all the way through from beginning to end, we could not begin to give the same degree of attention to each of those cases that the IRS provides. The IRS is the administrative agency. There has to be some deference to their judgment and their ability to carry out the basic tasks. What this provision does is to give Congress a little window to monitor what is going on. A veto power is not necessary to serve this purpose. ■