

doctrine be successfully used (or perhaps even unsuccessfully raised) against less obviously abusive transactions, Congress may revisit the penalties. Given this possibility, the strict liability provision may prove to act as a constraint on when the Service raises the doctrine and when courts use it to strike down transactions. For more on new section 7701(o), see Charlene D. Luke, *What Would Henry Simons Do?: Using an Ideal to Shape and Explain the Economic Substance Doctrine*, 11 Hous. Bus. & Tax L.J. \_\_\_ (forthcoming 2010), available at <http://ssrn.com/abstract=1647666>; Martin J. McMahon, *Living with (and Dying by) the Codified Economic Substance Doctrine*, University of Florida Levin College of Law Research Paper No. 2010-13, available at <http://ssrn.com/abstract=1623822>.

### Carried Interests

The issue of partnership carried interests has perhaps been generating even greater discussion than the codification of economic substance. Several proposals have been aimed at the carried interest problem, and at some point, it seems likely that the temptation of the revenue estimate tied to the provision will overcome the lobbying of various interest groups. While the use of partnerships to convert income character should be addressed, current proposals for section 710 seem far too convoluted. Many tax scholars have written about carried interests, but here in this brief comment, I will draw attention to the work of Karen Burke. She argues that section 707 could and should be used to deal with this problem, and she rightly points out that the problem is not simply a matter of character conversion but also of income shifting. A partnership has to have capital gains and other partners accommodating enough to allocate those capital gains away from themselves and to the holder of the carried interest. A flexible, regulatory solution would also seem more conducive to the handling of a tax avoidance problem. See Karen C.

Burke, *The Sound and Fury of Carried Interest Reform*, 1 COLUM. J. TAX L. 1 (2010); Karen C. Burke, *Fuzzy Math and Carried Interests: Making Two and Twenty Equal 710*, 127 TAX NOTES 885 (May 24, 2010).

### Character of Income

I will conclude with a pie-in-the-sky tax reform wish: Eliminate the distinction between capital and ordinary income. Just as source is essentially irrelevant to the question of whether something is an accession to wealth, it should be

irrelevant to the question of tax rate. If the disparity between ordinary and capital were removed, then, for example, while partners could still attempt to shift income among themselves, partnerships could no longer be used to convert ordinary gain to capital gain. Ending the difference in treatment between ordinary and capital would no doubt raise the profile of other types of tax-reduction techniques, but tremendous simplification still could occur and at least some tax-reduction behavior avoided. ■

## Wish-List for the Federal Tax System in the Year 2020

By Joseph M. Dodge\*

**T**wenty-twenty is fine for hindsight, but not for foresight. The only prediction I shall hazard is that few, if any, of the items on my wish-list below will be enacted.

The organizing theme of my wish-list for the Year 2020 is that the individual federal income tax be intelligible as a tax based on ability to pay and as simple as possible. Distinctions without a difference should be abolished. Given space constraints, I will try not to belabor the obvious, retread familiar ground, or deal with issues peripheral to the main theme (such as abolishing stepped-up basis). This is not the occasion for proposing radical changes, such as moving to a mark-to-market accretion tax, abolishing all tax expenditures, or radical simplification.

The estate and gift tax should be replaced by a “realization” accessions tax, which is a tax on unearned income (rather than a tax on death or entrepreneurial success). See Joseph M. Dodge, *Replacing the Estate Tax with a Re-Imagined Accessions Tax*, 60 HASTINGS L.J. 997 (2009), shorter version at 122 TAX NOTES 1151 (Mar. 2, 2009).

The corporate income tax has no justification except to raise revenue on a

“source” basis. There is no reason for it to be computed in essentially the same way as the individual income tax. The present system suffers from inaccurate accounting and an incentive to engage in tax-shelter activity. I would repeal the existing tax and replace it with a tax on corporate book income.

Turning to the individual income tax, a priority would be to simplify the structure of the tax computation, to wit:

1. All true tax expenditures (subsidies) should be converted into refundable tax credits, which would be summarized on a new Schedule X. (We can leave open the question as to what is a true subsidy. For example, I think charitable contributions should be a deduction, but others may disagree.)
2. The distinction between capital gains and losses should be abolished. (To placate the opponents of this move, I would offer a tax-free rollover investment account.) The problem of selective realization of

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losses would remain, but that could be dealt with separately (by, for example, allowing for offset by deemed realization of gains, to the extent of net realized losses, accompanied by step-up of gain property not to exceed FMV).

3. The AMT, rate bubbles, and deduction phase-outs should be eliminated. There should be no “worksheets” except for refundable credits.
4. The standard deduction should be eliminated and replaced by a system of personal and dependency deductions that should, in the aggregate, aim to achieve an amount equal to the household subsistence level (which I would envision as being at least \$40,000 for a family of four). The “child tax credit” could be eliminated. This approach would eliminate a sizeable percentage of taxpayers from the income tax system.
5. The distinction between above-the-line and below-the-line deductions would be eliminated, and there would be no category of “miscellaneous itemized deductions.” However, there would be “floors” (and possibly ceilings) attached to certain deductions. Floors would be designed, in part, to disallow items that are already included in “subsistence” allowances.
6. There would be a floor (1% or 2%) under the charitable contribution deduction. This would eliminate accounting for trivia and create an incentive to give in excess of the floor.
7. There is no reason to allow deductions for items (medical costs and casualty losses) that can and should be insured against. High-income persons can buy insurance for most kinds of losses. Additionally, a “tax” justification for a deduction for uninsured personal casualty losses is absent, because the “consump-

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## There is no reason for [the corporate income tax] to be computed in essentially the same way as the individual income tax.

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8. The income tax base is supposed to be a “difference” principle. Individuals pay state and local taxes in roughly the same percentage of gross income. Therefore, accounting for these taxes seems unnecessary. The only way a person would incur extraordinary state and local taxes is by acquiring vacation homes (thereby incurring additional property taxes), but in that case the property taxes can be viewed as “discretionary,” i.e., not deductible as a matter of right. Therefore, the deduction for taxes should be eliminated except for taxes that are business or investment costs.
  9. Although complete repeal of the mortgage interest deduction may be unrealistic, it can be eliminated (as a matter of right) for second or third homes, and (possibly) the limit on principal for primary residences can be reduced to about \$250,000.
  10. The tax treatment of residences used more than a *de minimis* amount for personal use during the year (herein referred to as “vacation homes”) is unnecessarily complex. These homes are basically consumption disguised as “investments.” In the two previous items, the deductions-as-of-right for vacation-home mortgage interest and property taxes were eliminated. The next target is depreciation. Vacation homes are kept in repair, and there is no obsolescence. Therefore, depreciation should be totally disallowed (leaving basis intact). All costs (that don’t expand capacity) would be treated as “repair expenses.” Any rental activity with respect to a vacation home would then be treated as a “not-for profit activity.” Accordingly, all costs (including mortgage interest and taxes) allocable to rental use would be deductible from gross rents, but not in excess thereof, and with no carryovers.
  11. The tax distinction between alimony and child support should be abolished, so that all payments (that are not property purchases) would be subject to a deduction/inclusion regime.
  12. All damages for personal injury should be included (and costs of obtaining recoveries should be deducted). Most tort claims are settled, and the allocation between taxable and non-taxable recoveries is inscrutable. There is no tax justification for the distinction between physical and non-physical injuries. Awards would increase (to cover the plaintiff’s incremental tax liability), and defendants would pay the full social cost of their anti-social activities.
- If these proposals were enacted, most (non-business) taxpayers should be able to prepare their own tax returns without the need for tax return preparers or even computer software. ■