THE POLITICS OF TAXATION: WHO PAYS WHAT, WHEN, HOW

By

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Introduction

Budgeting addresses one of the fundamental questions of politics: How shall the resources of the government be employed? The budget is a map or blueprint for what political scientists refer to as the authoritative allocation of resources by the state. For any particular year, the nature of that allocation is the product of a dynamic process of politics. The budget codifies all the many political bargains, commitments, and compromises made throughout the year. As such, the budget implements broad national public policies, finances the many programs of the social welfare state, distributes pork-barrel benefits to local districts, and promotes the partisan policies of the two major national political parties. The budget is a *political* instrument because it speaks to what the late Harold Lasswell saw as the central concern of politics: "who gets what, when, how."

The budget is only one side of the authoritative allocation of resources by the U.S. government; public finance is the other. How the government raises the revenue that finances its various activities ultimately dictates who *pays* what, when, how. The nature, structure, and incidence of a system of public finance all impact upon how the various economic and social interests of civil society will share the burden of government, i.e., who will pay for the appropriations authorized in the budget. The design of a system of public finance determines how that economic burden will be distributed and hence, raises political issues of the utmost importance.

In the twentieth century, the income tax has been the principal source of revenue of the U.S. government. The great revenue brought in by the income tax financed two world-wide military campaigns and made possible (with payroll taxes) the establishment of a social welfare state in the 1930s. The post-New Deal American state has been funded largely through the income tax. Because of the centrality of income taxation in public finance, the politics of the income tax *is* the politics of revenue in the United States. The particular structure of the income tax is a constant concern of federal policymakers, as well as an army of Washington lobbyists representing special interests jockeying for political favors bestowed through the tax code. The many exemptions, deductions, credits, and social policies written into the tax laws express political decisions and bargains—just as appropriations in the federal budget express political decisions and bargains over funding particular public policies and programs. As such, the federal income tax is a *political instrument* that effects an authoritative allocation of resources.

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While the tax laws (like the budget) allocate resources among various economic, social, and regional interests, the politics of taxation is quite distinct from that which prevails in the Appropriations and Budget Committees over the budgetary process. Tax policy is expressed in its own distinct language—the arcane language and technical jargon of tax law. Likewise, the politics of taxation is located in its own distinct political arena—the House Ways and Means and Senate Finance Committees. While tax policy proposals commonly originate in the White House, and congressional leadership and committee staff (i.e., the staffs of the Joint Committee on Taxation, Ways and Means, and Finance) have considerable influence over the course and success of tax policy initiatives, the tax laws are mostly the product of the preferences and bargains struck by and among the most powerful members of the tax committees. The chairmen of the tax committees play a dominant role in shaping tax bills through their mark-up of legislative proposals. Presidents may set the agenda for tax policy by initiating legislative proposals, but tax bills are largely the handicraft of the tax committees.

Because tax policy is made by elected politicians, decisions inevitably reflect compromise, consensus, coalition-building, as well as partisan politics. Elected politicians must carefully cultivate support for their revenue policies (especially those that increase taxes) as they are ultimately accountable to the electorate. Furthermore, because tax policy is made by elected politicians, it is highly susceptible to the pressures and influence of powerful, organized interest groups in the districts of congressional policymakers. This much was already recognized by T. S. Adams in his 1927 presidential address to the Annual Meeting of the American Economic Association: "[M]odern taxation or tax making in its most characteristic aspect is a group contest in which powerful interests vigorously endeavor to rid themselves of present or proposed tax burdens. It is, first of all, a hard game in which he who trusts wholly to economics, reason, and justice, will in the end retire beaten and disillusioned."[2]

It is this politics of taxation—the "hard game" played by presidents, committee chairmen, congressional leadership, and powerful organized interests—that is the subject of this paper. What then are the motivates, goals and interests of those politicians who make U.S. tax policy?

Politics and Revenue

The revenue policy of any state inevitably reflects a complicated calculus of decision-making. Policymakers take into account numerous interests and goals dictated by the overall constitutional structure of the regime. As political scientist Sven Steinmo has put it: "[P]oliticians want to be reelected, bureaucrats want to manage a stable and efficient tax policy, and interest groups want to promote the well-being of their constituents. But how these general desires get translated into specific policy preferences and specific political strategies depends upon the rules of the game; and the rules of the game are written by the institutions through which the game is played."[3] Thus, to make sense of the politics of taxation in the United States,

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[2] T. S. Adams, "Ideal and Idealism in Taxation," 18 *Am. Econ. Rev.* 1 (1928).

[3] Sven Steinmo, *Taxation and Democracy: Swedish, British, and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993), 10.

it is first necessary to understand the “rules of the game”—namely, the political processes and institutions through which the tax laws are made.

The political institutions and procedures established under the U.S. Constitution for legislation are important, but do not alone define the rules of tax policymaking. The extraconstitutional party system that evolved in the early nineteenth century has also had an important impact on the legislative process. Those officials who write the tax laws are *politicians* who must periodically seek reelection. Their very claim to office is dependent upon winning election in their local district or home state; elections link congressional policymakers to their constituents. Much has been written by political scientists about how this “electoral connection” influences the behavior of members of Congress, who introduce legislation and seek credit for the introduction of favorable legislation and the actual distribution of government benefits constituents in their home districts.[4] It is because of the electoral connection that the tax legislative process is so susceptible to the pressures and entreaties of interest groups located in the local districts or states of the most important members of Congress.

However, while this side of the politics of taxation is important, tax policy is much more than the product of interest group politics. Those politicians in control of the tax legislative process pursue other political interests and goals as well through the tax laws. Because U.S. tax policy is made within the context of a competitive party system, it is also highly partisan. The same elected politicians who represent local single-member districts must operate *within* Congress as members of their political party.[5] While members of Congress do not always vote with their party, party affiliation remains the single most important factor in predicting voting behavior.[6] In the 1980s and 1990s, voting on major tax legislation has pretty much followed strict party lines as Democrats and Republicans have used the tax code to implement much of their respective partisan agendas—and consistently voted against each other’s partisan proposals. A good deal of the outcomes of tax policymaking can be explain by reference to the ebb and flow of party politics—most specifically, the competition between the two dominate national parties.

The American political culture is also important in defining the environment for the tax legislative process. Endemic to the American political culture is a strong, native strain of antitax politics that surfaces from time to time. Individual politicians or entire political parties express this antitax rhetoric periodically. In the twentieth century, the Republican Party has generally carried the antitax banner; however, Democrats too have found this a useful campaign theme.

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[4] See Morris P. Fiorina, *Congress: Keystone of the Washington Establishment* (New Haven: Yale University Press, 1977), and David R. Mayhew, *Congress: The Electoral Connection* (New Haven: Yale University Press, 1974).

[5] An important new study of the folkways of contemporary legislative politics is Barbara Sinclair, *Unorthodox Lawmaking: New Legislative Processes in the U.S. Congress* (Washington, D.C.: Congressional Quarterly Press, 1997).

[6] See, e.g., Jerrold E. Schneider, *Ideological Coalitions in Congress* (Westport, Conn.: Greenwood Press, 1979).

Occasionally, the antitax message prevails and is translated into public policy—as in the major tax bill of 1981, and to a lesser extent, the tax legislation enacted in 1997 and 1998. In a particularly revealing recent episode, House Republicans passed a bill in June 1998 to simply terminate the federal income tax by July 4, 2002. This is the kind of antitax sentiment that lurks just under the surface of the tax legislative process, thereby defining the parameters of the debate over U.S. tax policy.

Finally, Congress is charged under the Constitution with the great responsibility and burden of raising the enormous revenue required to pay for the activities of the federal government. A good deal of the time of members of the tax committees is spent scrambling to find the revenue to fund the various proposals authorized in the budget. This is especially the case in light of the requirement for "revenue neutrality" imposed on the tax and budget committees under the so-called pay-as-you-go (or PAYGO) rule adopted in the Budget Enforcement Act of 1990.[7] Every bill that gives away revenue through some new special tax preference or rate reduction must be accompanied by an offsetting revenue-raiser in the congressional budget resolution. For every new "mandatory" (i.e., non-entitlement) program or public policy authorized in the budget, the tax committees must come up with new revenue. Likewise, proposed tax cuts must be accompanied by matching revenue-raisers. In the best of economic times (for instance, the past six years of sustained economic growth), a constant and unrelenting search for revenue is behind much of the politics of taxation. Under the rules of PAYGO, the scramble for revenue is even more intense. But political and electoral constraints make raising revenue a very difficult feat for politicians. Accordingly, policymakers must carefully build support for any tax increase, putting together broad coalitions and cultivating acceptance among the electorate. Of course, politicians are tempted to take the "easy" routes—e.g., disguising tax increases as phase-outs of exemptions for high-income taxpayers, or in the good old days before 1981 when the tax brackets were indexed for inflation, relying on the increased revenue from so-called bracket creep.

To summarize: tax policy is made within the confines of specific political institutions (Congress, committees) and strongly influenced by the electoral connection (elections, party competition). Policymakers act within a complex environment, motivated by competing goals and interests defined by the constitutional structure and influenced by a deeply rooted antitax tradition that characterizes the American regime. Within this context, members of Congress and the tax committees use the tax code as an instrument in furtherance of what are, in essence, three main functions—raising revenue, serving constituents, and implementing partisan policies. These functions of the income tax are explored further below. Tax policy is often at odds with itself because congressional policymakers use the tax laws in furtherance of these disparate and often conflicting purposes. All of the omnibus tax bills enacted in the past three decades include provisions dedicated to the pursuit of one or another of these various functions.

Elsewhere, I have argued that because the tax laws are so used for conflicting purposes, contemporary American tax policy has become increasingly unstable, unpredictable, highly

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[7] 2 U.S.C.A. §§ 633(c), (f), and 902 (Title 6, "Budget Agreement Enforcement Provision"), amending the Congressional Budget Act of 1974.

partisan, and exceedingly complex.[8] This has had undesirable consequences for U.S. tax policy. The highly erratic pattern of tax policymaking and the explosion in the volume and complexity of the tax legislation and regulations enacted in the 1980s and 1990s bear witness to this. On the other hand, it must be acknowledged that the income tax remains remarkably successful in satisfying so many of the political interests of policymakers at once, while at the same time raising the enormous revenue that it does—an amazing $919 billion in 1997.

Revenue and Predation

Officials of any state face a common concern: raising revenue to fund the various activities of the state, ranging from military campaigns to social welfare programs. The particular method employed varies from regime to regime, but one way or another, officials must extract revenue from civil society to support the state. In authoritarian regimes, raising revenue may take the guise of outright seizure—the state plundering civil society. Elsewhere, where civil society is better organized to resist state predation, state officials must negotiate for revenue with the major social and economic interests. This requires state officials to offer a tacit *quid pro quo*—protection, order, and public goods in exchange for revenue. In such cases, revenue is generally raised through regular, institutionalized methods of extraction.

Modern states use a variety of institutionalized methods of revenue extraction: custom duties, user fees, tariffs. In some cases, state-owned economic business enterprises generate revenue for the government. However, taxation is the by far the dominant method used by modern states to finance their activities; all the other methods of public finance merely supplement the revenue raised by taxation in its various forms. And everywhere the underlying relationship between taxation and the modern state is the same: "Taxes are the source of life for the bureaucracy, the army, the priests and the court, in short, for the whole apparatus of the executive power."[9]

That the state must raise revenue to survive is obvious. Some theorists carry this observation one step further, arguing that state officials seek to *maximize* state revenue as predatory rulers. For example, economists Geoffrey Brennan and James Buchanan portray the state as an unrelenting "Leviathan" constantly seeking to maximize its own revenue.[10] They base their analysis upon this single premise—that the state behaves like a monopolist seeking to maximize its own profit (rent). The state as monopolist imposes taxation so as to maximize its revenue, ignoring the "excess burden" (or deadweight social loss) imposed on society and the private economy. From this perspective, the goal of politics becomes one of circumscribing

[8] Sheldon D. Pollack, *The Failure of U.S. Tax Policy: Revenue and Politics* (University Park: Penn State Press, 1996).

[9] Karl Marx, "The Eighteenth Brumaire of Louis Bonaparte," (1852) in *Karl Marx: Selected Writings* (D. McLellan, ed.) (London: Oxford University Press, 1977), p. 320.

[10] Geoffrey Brennan and James Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press, 1980).

constitutional boundaries around the state to limit Leviathan's self-aggrandizing. Political scientist Margaret Levi offers a similar and in many ways more sophisticated political theory of predatory rule, arguing that "rulers are predatory in that they try to extract as much revenue as they can from the population."[11]

While there is a certain appeal to the notion that revenue maximization motivates state officials, in practice predation theory just does not explain very much about the politics of taxation in the United States. Or more properly, it explains only one aspect of the politics of taxation. Unlike the French and English monarchs of the sixteenth century (bona fide revenue predators), national political elites in the United States have always lacked both the institutional power and political will to engage in predatory revenue policy. As a result of the peculiar institutional development of the American state, the national government lacked significant centralized powers until well into the twentieth century.[12] At its inception, the American state was expressly designed through its original constitutional structure to *deny* the federal government easy access to revenue. Under the first, ill-fated constitution of the states—the Articles of Confederation (1777-1789)—the national government was itself denied the power of direct taxation. The national government was dependent upon the state governments to collect and pay over revenues, which the states often did not do. While the new U.S. Constitution of 1789 strengthened the fiscal powers of the central government, it still possessed limited powers, especially with respect to raising revenue. Lacking the institutional powers to raise revenue, much less to engage in predatory revenue policy, the nineteenth century American state relied on a hodgepodge system of excise taxes and custom duties, supplemented by the occasional sale of public lands, to fund its rather minimal activities. Actually, this system was adequate in financing the limited activities of the federal government—until the Civil War, when the administrative capacities of the federal government were expanded far beyond the traditional nineteenth century functions. To supplement federal revenue (as well as borrowing), an income tax was enacted in 1860—and allowed to expire soon after the war.

Throughout the nineteenth century, the U.S. government was largely financed by the tariff—a commodity-based consumption tax on imported goods and materials. The tariff was a highly successful source of revenue that regularly produced annual budget surpluses for the federal government.[13] Nevertheless, political and regional pressure mounted for replacing the tariff with an income-based tax, and opposition to the tariff emerged as the defining political issue of the era. "[D]uring the 1880s and 1890s, the two competing political parties came to base their economic appeals on sharply conflicting ideological views of the tariff and of taxation in

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[11] Margaret Levi, *Of Rule and Revenue* (Berkeley and Los Angeles: University of California Press, 1988), p. 3.

[12] Stephen Skowronek, *Building A New American State: The Expansion of National Administrative Capacities, 1877–1920* (New York: Cambridge University Press, 1982).

[13] James D. Savage, *Balanced Budgets and American Politics* (Ithaca, N.Y.: Cornell University Press, 1988).

general."[14] Calls for a graduated income tax first appeared in the 1877 and 1878 platforms of the Greenback Party, and again in the 1880 platform of the National Greenback Party. Grangers, Knights of Labor, and the Farmers Alliance favored an income tax, as did the Populist Party in each of its platforms. From 1874 to 1894, no less than sixty-eight bills were introduced in Congress proposing an income tax.

The constituents of the political parties understood that replacing the tariff with an income tax meant shifting the burden of public finance away from Southern and Midwestern agrarian interests and onto Northern manufacturing interests and wealthy individuals. The intensity of the politics reflected the salience of the issue for those interests, groups, and regions affected. A new federal income tax was finally enacted in 1894, largely at the instigation of Populists in the Democratic Party. The politics of the federal income tax of 1894 (which was subsequently held unconstitutional by the U.S. Supreme Court[15]) and that surrounding the subsequent ratification of the 16th Amendment in 1913, was highly partisan and reflected the economic and regional cleavages.

Ironically, the enactment of a new federal income tax, a minor revenue bill attached to the Underwood-Simmons Tariff Act of 1913, proved anticlimactic once the constitutional question was resolved.[16] Reflecting political compromise, the income tax of 1913 applied to only a few of the wealthiest citizens. This was accomplished through a generous $3,000 personal exemption which rendered only a relatively small and well-defined stratum of the citizenry subject to the income tax. For 1913, the first half year under the tax, only 0.8 percent of the population had sufficient income to subject them to taxation; only 358,000 individuals filed income tax returns reporting net taxable income.[17] For these, the tax was imposed at 1 percent on personal income above $3,000, increasing to 6 percent on income over $500,000. With a 1 percent surtax, the maximum marginal tax rate reached 7 percent. In 1913, the corporate and individual income tax together raised only $28 million. For 1914 (the first full year), the income tax provided just 7.37 percent of total receipts of the federal government.

While the new income tax was initially only a minor supplement to the tariff, the increased demand for revenue during World War I forced congressional policymakers to expand the tax. This was easily accomplished by reducing personal exemptions and by raising tax rates. In addition, corporate rates were raised, and an excess profits tax was enacted. By the end of the war, the top marginal tax rate soared to 77 percent on income over $1 million. Personal exemptions were lowered to $1,000 for single taxpayers and $2,000 for married taxpayers. These changes in the rate structure of the income tax occasioned by the war shifted the burden of

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[14] W. Elliot Brownlee, *Federal Taxation in America: A Short History* (New York: Cambridge University Press, 1996), p. 35.

[15] *Pollock v. Farmer's Loan & Trust Co.*, 157 U.S. 429c (1895); 158 U.S. 601 (1895) (rehearing).

[16] Pub. L. No. 63-16, chap. 16, 38 Stat. 114, 166–81.

[17] The revenue collected under the first year of the income tax was reported in "Letter of the Secretary of the Treasury, William G. McAdoo," 63d Cong., 3d sess. (October 15, 1914), S. Doc. 623, 2.

the tax from the very wealth exclusively to include middle-income taxpayers. (Even still, at the height of the war only a minority of the citizenry was ever subject to the tax; no more than 20 percent of the population was required to file tax returns.) When the steeply graduated income tax was applied to a wider spectrum of the population, it produced revenue beyond anything previously imagined. By 1918, revenue from the wartime income tax and excess profits tax supplied 63.1 percent of total federal receipts; revenue from the tariff and all other excise taxes declined to 28.7 percent. The income tax supplanted the tariff as the principal source of federal revenue.

Tax rates were reduced significantly during the 1920s during successive Republican administrations. President Warren G. Harding left tax policy mostly to his treasury secretary, Andrew W. Mellon, who led his famous campaign for a return to "tax normalcy." While tax rates were lowered throughout the 1920s, budget surpluses were actually generated—and the relative contribution of the income tax to total federal revenue increased. By the end of the decade, tax rates and federal expenditures had been returned to prewar levels and the federal income tax was pretty much what it had been in 1913. This changed dramatically with the onset of the Second World War.

It is often said that World War II transformed the federal income tax from a "class" tax into a "mass" tax. Before the war, only a few wealthy citizens were subject to the income tax. By the end of the war, the vast majority of U.S. citizens had become taxpayers. The Revenue Act of 1942 lowered personal exemptions to only $500 for individuals and $1,200 for a married couple. This expanded the application of the tax to the vast majority of the citizenry. The expansion of the tax base was evidenced by the number of tax returns filed by individuals, which increased nearly eightfold from 1940 to 1945. The number of individuals subject to the income tax increased over the course of World War II, eventually reaching over 74 percent of the population. In addition, the Revenue Act of 1942 raised the normal personal income tax from 4 percent to 6 percent and added a progressive surtax ranging from 13 percent on income over $6,000 to 82 percent on income over $200,000. By 1944, the top marginal tax rate rose to 94 percent for individuals (on income in excess of $2,000,000) and 40 percent for corporations (in addition to the excess profits tax).

As income tax rates were increased and exemptions lowered during the war, the volume of revenue collected under the income tax increased dramatically. Total federal receipts from the income tax rose sevenfold; revenue derived from the federal income tax (corporate and individual combined) increased to $34 billion for 1945. The impact of World War II on the structure and functional role of the federal income tax can be summarized as follows: tax rates increased, personal exemptions were lowered, revenue increased, and a majority of the population became subject to the tax. Most significantly, the changes made to the tax code to finance World War II were not withdrawn after the wartime crisis ended, as had been the case following the First World War. In 1950, 59 percent of the population was subject to the individual income tax; the figure increased to 81 percent by 1970. Revenue from the individual income tax, which provided over 45 percent of federal receipts at its wartime peak in 1944, has since remained at a constant 40 to 45 percent of federal receipts.

Since World War II, the income tax has been the cornerstone of the system of public finance in the United States. For fiscal year 1997, the corporate income tax provided 11.5

percent of federal revenue and the individual income tax 46.7 percent. Collectively, this totaled $919 billion—significantly exceeding prior budget revenue estimates. Revenue from the income tax was supplemented by wage taxes (34.2 percent), the federal estate and gift tax (1.3 percent) , excise taxes (3.6 percent), and miscellaneous user fees (2.7 percent). These other sources of revenue are hardly insignificant, and in an era of budget deficits and "revenue neutrality," all sources of revenue are pursued. But it is the income tax that finances the activities of the modern American state. This is especially the case given that the revenue raised by federal wage taxes (for 1998, imposed at a total rate of 15.3 percent on the $68,400 wage base and at 2.9 percent on wages above that amount) is specifically earmarked for the various social security programs. Separating social security from the rest of the activities of the federal government, the income tax provides some 88 percent of the revenue for those programs.

Most interesting, while the income tax has enormous capacity to raise revenue, policymakers obviously do not use the income tax to *maximize* revenue for the state, except during the revenue crises experienced during most wars. In peacetime, policymakers find it irresistible to use the income tax for political purposes—which typically means introducing legislation to *reduce* taxes for favored interests and groups, or implement public policies through tax preferences that likewise reduce taxation for favored investments or programs. Such unabashed political use of the federal income tax makes little sense from the perspective of the state's purported interest in maximizing revenue. However, it makes all the sense in the world from the perspective, interests, motives, and goals of individual policymakers. The political interests of individual congressional policymakers dictate in favor of using the income tax to cultivate support among constituents and implement public policies through the tax code. This results more often in pork-barrel tax legislation than revenue predation.

While revenue concerns constantly press upon federal policymakers, their behavior hardly comports with a model of revenue predation. The continuous enactment of tax preferences, over twenty years of budget deficits, and a national debt of $5.5 trillion bear witness to this. It is not that policymakers are inept as revenue predators. Rather they are subject to considerable political pressure from constituents to help alleviate the impact of the highly progressive rate structure of the income tax. As politicians, they are highly skilled at using the tax laws to assist constituents to enhance their own political standing. The politics of taxation necessarily involves raising revenue, but raising revenue requires consent and support from constituents and party. As Irene Rubin has put it: "The politics of taxation is not a politics of coercion, it is a politics of persuasion."[18] It should be added that the politics of taxation is also a politics of accommodation—distributing benefits to supporters and constituents through the tax code. Rather than would-be Leviathans, federal policymakers are rational politicians who use the tax laws for a variety of *political* purposes. Raising revenue is but one of those political purposes.

Partisan Politics and the Income Tax

[18] Rubin, Irene S., *The Politics of Public Budgeting: Getting and Spending, Borrowing and Balancing* (Chatham, N.J.: Chatham House, 3d ed. 1997), p. 66.

One of the main uses of the income tax by politicians is as a means for implementing their partisan agendas. This use of the federal income tax reflects the fact that early in the history of the nation the major political parties cultivated their own very distinct fiscal and tax policies. In the nineteenth century, the parties were sharply divided over the tariff. Later, the conflict was over income taxation. Since the modern income tax was enacted in 1913, Democrats and Republicans have disagreed on many substantive issues of tax policy—even while finding considerable bipartisan agreement over a wide range of policies (the oil and gas depletion allowance, the deduction of charitable contributions, and increases in social security benefits—to name a few). When in control of the legislative process, the parties have enacted a good deal of their respective partisan agendas through the tax laws.

In recent decades, Democrats have enacted a wide assortment of partisan tax policies: tax credits for low-income earners, housing, and education; the deduction of home mortgage interest to encourage home ownership; tax preferences for employee stock ownership plans (ESOPs) and retirement plans to benefit labor; limits on executive compensation; and preferential tax treatment for employer-provided health insurance. Democrats favor a steeply progressive income tax with high rates for the wealthy and tax preferences for the constituents of the Democratic Party—labor, unions, the poor, etc. A significant portion of the social welfare state of the United States is funded through "indirect spending" via the tax expenditure budget.[19]

Republicans too have pursued a similarly wide range of social and economic policies through the tax code. Their tax policies are designed to implement some of the most fundamental tenets of the Republican Party: broad income tax cuts to stimulate the economy, preferential tax treatment for capital gains, tax-favored economic "enterprise zones" as a cure for urban blight, and various tax credits and expenditures aimed at encouraging savings, investment, and the accumulation of capital. The list goes on and on. The most significant difference between the tax policies of congressional Democrats and Republicans lies in the particular policies they choose to write into the tax laws, rather than whether or not to use the tax laws to implement policies.

Why have policymakers in both parties found the tax code such an inviting vehicle for implementing public policies? The tax legislative arena, as compared to that of budgeting and appropriations, has proved to be generally more accessible and hospitable to the personal interests, ambitions, and goals of individual congressmen. It is simply easier to provide constituents with benefits through the tax code than through direct budgetary expenditures.[20] Tax expenditures are often highly technical and hence, are less visible to the public (and media) than direct budgetary expenditures. The members of the tax committees are particularly advantaged in providing such tax preferences to constituents; higher levels of campaign

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[19] Federal spending for social welfare *via* tax expenditures is the subject of a new study. Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton: Princeton University Press, 1997).

[20] Thomas J. Reese, *The Politics of Taxation* (Westport, Conn.: Quorum Books, 1980), pp. 198–201.

contributions evidence the importance of such strategic committee assignments.[21] Once adopted, programs enacted through the tax code typically have an indefinite life, rather than requiring annual authorization—as do budgetary programs. For these reasons, partisans on both sides of the aisle find the tax code to be a convenient instrument for implementing their favored public policies. As a result, the tax laws, ostensibly designed to raise revenue, provide all sorts of economic incentives that reduce the tax burden for those who engage in the tax-favored behavior. Public policies executed through tax preferences erode the tax base and reduce revenue for the Treasury. They also are a less efficient means of funding public policies, as tax benefits are distributed too broadly, with some of the economic incentives going to those who would have engaged in the favored activity without the tax preference. Furthermore, the revenue loss from tax preferences is difficult to predict and control as statutes are open-ended invitations to an unlimited number of taxpayers to take advantage of the favored tax treatment. Notwithstanding these shortcomings, the use of the tax laws by congressional policymakers in pursuit of their own political agendas is an integral component of the normal politics of taxation.

Taxation and Constituency Service

Beyond those expenditures that implement partisan agendas, the tax preferences that congressional policymakers find most conducive to satisfying their ambitions and goals as elected politicians are those targeted to their own constituents. Politicians use the income tax to cultivate support from the dominant economic and social interests in their districts and states. The congressman as ombudsman introduces amendments to the income tax that are intended to protect and enhance the economic well-being of local interests and constituents. In this way, the income tax code is also used as a nonpartisan vehicle for politicians, Democrats and Republicans alike, to curry favor with constituents. This results in numerous special-interest provisions buried within the arcane language of the income tax code. A simple examination of the Internal Revenue Code will reveal that a significant portion of the eight hundred or so provisions of the federal income tax are dedicated *not* to raising revenue, but rather to implementing policies that effectively reduce federal revenue by allowing special deductions, exemptions, or credits to favored groups, interests, or policies.

The so-called tax expenditure budget evidences the use of the tax code by congressional policymakers as a tool for implementing public policies and distributing benefits to constituents *via* special tax preferences. Tax expenditures are defined by statute as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[22] Because policymaking through tax expenditures is relatively easy and conducive to the political and electoral needs of representatives and senators, it has become a

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[21] John Manley, *The Politics of Finance: The House Committee on Ways and Means* (Boston: Brown, Little, 1970); Randall Strahan, *New Ways and Means: Reform and Change in a Congressional Committee* (Chapel Hill: University of North Carolina Press, 1990).

[22] Congressional Budget and Impoundment Act, Pub. L. No. 93-344, sec. 3(a)(3), 88 Stat. 298, 299 (1974).

common mode of congressional policymaking in the post-War era. Stanley Surrey and Paul McDaniel calculated that the volume of government spending through tax expenditures increased by 179 percent from fiscal year 1974 to fiscal year 1981.[23] Reform efforts in 1986 went far in eliminating many special tax preferences and reduced the rate of growth in the tax expenditure budget. However, the spending spree picked up steam again in the late 1980s and early 1990s. A recent study by the General Accounting Office estimated that tax expenditures totaled almost $402 billion in 1993 and would continue to increase annually by 4 percent.[24] That projection turned out to be fairly accurate. According to the president's budget for fiscal year 1996, the revenue loss attributable to federal income tax expenditures was $533 billion—a 5.2 percent increase over 1995. For fiscal year 1997, the total revenue loss attributable to tax expenditures was $554 billion—a 4.1 percent increase over 1996. Projections for fiscal year 1998 put the figure at $567 billion, evidencing a modest reduction in the rate of increase in the tax expenditure budget. While measuring the total revenue loss attributable to tax expenditures is problematic,[25] these figures provide evidence of the overall tendency of policymakers to spend through tax expenditures.

One revealing example of how the tax laws are used by politicians to curry favor with local interests can be found in the legislation crafted by congressional Republicans in 1995 to implement their partisan agenda. A massive tax bill was included in the omnibus revenue bill known as the Seven-Year Balanced Budget Reconciliation Act of 1995. Even while trying to implement their party's policy agenda (the so-called Contract With America), the politicians on the tax committees could not resist the opportunity to introduce some special provisions designed to advance the economic well-being of constituents. For instance, Republicans on the Ways and Means Committees included in the House draft three provisions for the funeral industry. While these were minor provisions with limited revenue impact (collectively losing only $500,000 in annual revenue), the only justification for including them in the bill was that four committee members had particularly close ties to family-run funeral businesses. Senate Republicans had their own list of special-interest provisions buried in the tax bill. Indeed, every Republican on the Finance Committee, save for conservative presidential candidate Phil Gramm of Texas, had some special-interest provision inserted in the Senate bill. Beneficiaries (and their respective supporters on the Finance Committee) included newspaper companies (Robert Dole of Kansas), small gas and electric companies (William Roth of Delaware, the home of the Delmarva Power & Light Co.), water utilities and real estate developers (Charles Grassley of Iowa), college football coaches (Orrin Hatch of Utah, a close friend of Brigham Young University's football coach), life insurance companies (Alfonse D'Amato of New York), and independent gasoline marketers (Don Nickles of Oklahoma).

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[23] Stanley S. Surrey and Paul McDaniel, *Tax Expenditures* (Cambridge: Harvard University Press, 1985).

[24] General Accounting Office, "Tax Policy: Tax Expenditures Deserve More Scrutiny" (GAO/GGD-AIMD-94-122) (June 3, 1994).

[25] See Bruce Davie, "Tax Expenditure Budgets" in *The Handbook of Government Budgeting*, Roy Meyers, ed. (San Francisco: Jossey-Bass Publishers, forthcoming November 1998).

None of these special-interest provisions actually made it into law as President Clinton vetoed the bill in December 1995. But proposals such as these circulate every time a tax bill is crafted, and many eventually find their way into the tax code. The Taxpayer Relief Act of 1997 reads like a Christmas-list of special tax provisions targeted at constituents of the Republican Party. For example, the legislation reduced the maximum tax on capital gains for individuals to 20 percent (a perennial goal of Republicans since the preferential rate for capital gains was repealed in 1986), lessened the burden of the corporate alternative minimum tax and eliminated it altogether for small business corporations, and increased current exemptions to the federal gift and estate tax—as well as creating an entirely new $700,000 exemption for owners of small businesses and farms. The Republican bill also included provisions expanding the availability of Individual Retirement Accounts (IRAs) and creating a new "Roth IRA" (named after Finance Committee chairman Roth, who now has the dubious honor of being the only individual having a section of the tax code named after him). Because any tax bill requires a broad nonpartisan coalition behind it, Republicans were forced to make concessions to Democrats. The Clinton administration was behind several new education tax credits, a provision that effectively eliminates tax on the sale of a home, and proposals to shut down certain "abusive" financial transactions designed by Wall Street investment firms to allow clients to defer gain realized on stock and securities. These provisions had been originally proposed by the Clinton administration in 1995 in response to the GOP's Contract With American tax bill, and were included in the 1997 tax bill as a compromise to secure the president's support (or at least, tacit acceptance) for the bill.

None of this is to suggest that Republicans are any more prone than Democrats to use the tax laws for constituency service. Democrats who controlled Congress and the tax committees for decades before 1994 used the tax laws for the very same purposes, favoring their own constituents and implementing their own partisan agenda through the tax code. Both sides of the political spectrum appear equally enamored of the electoral benefits derived from using the tax code to provide nonpartisan constituency service to the home district. The point is that even those who campaign on a strong antitax theme are all too ready to use the tax laws to distribute benefits to their own constituents. Indeed, as soon as predictions from the Congressional Budget Office of a small budget surplus for fiscal year 1998 began circulating in late 1997, politicians of all political stripes scrambled to propose new ways to "spend" the greater-than-anticipated income tax revenue pouring into the Treasury on account of the booming economy—with Democrats in Congress and the White House generally favoring "dedicating" any surplus to the Social Security trust fund and Republicans proposing tax rate reduction, as well as several new tax preferences (e.g., tax credits for educational expenses, including private school tuition, and a further reduction in the preferential rate for capital gains).[26] Unfortunately for the GOP, the aforementioned PAYGO provisions in the Budget Enforcement Act of 1990 bar Congress from so using a budget surplus to fund tax cuts.[27] To solve this dilemma, Rep. John Kasich (chairman

[26] For a reasoned discussion of the various arguments over a potential surplus, see Herbert Stein, "At Sea With Surpluses," *Wall St. J.*, May 19, 1998, A22.

[27] See note 7.

of the House Budget Committee) has proposed repealing the offending sections of the budget law.[28]

In the context of the two-party system in place since World War II, consensus is required to enact the kind of massive, omnibus tax legislation that has become commonplace. This consensus is achieved through a wide dispersal of benefits to produce majoritarian coalitions of convenience. A nonpartisan pattern of trading votes for tax benefits (logrolling) insures passage. This practice has been the norm for postwar tax legislation. The resulting tax policy has left the tax code riddled through and through by a dizzying array of tax credits, preferences, and deductions. In turn, this creates pressure on the rate structure of the income tax as policymakers struggle to make up the revenue shortfall attributable to the tax expenditures. The overall result is a steeply graduated rate structure, a broad tax base, and numerous tax expenditures granting relief to constituents of *both* political parties. The result is a "piecemeal, complicated, inconsistent, and inequitable tax structure that periodically needs overhauling."[29] Occasionally, reform legislation is passed. More often, the rhetoric of tax reform is invoked by politicians who wish to distance themselves from their own creation—the tax code. In short, it is an understatement to say that contemporary U.S. tax policy is a highly complex, almost schizophrenic enterprise.

Antitax Politics in the United States

Adding to the schizophrenic nature of U.S. tax policy is a deeply-rooted tradition of antitax politics in American political history. Strong antitax politics has shaped our political history from the Whiskey Rebellion of 1794 (a regional rebellion in western Pennsylvania against collection of the first federal excise tax, which was imposed on distilled spirits) to the so-called Proposition 13 antitax movement that began in California in the early 1970s. The antitax populism behind the Proposition 13 movement—a revolt against local California property taxation—was a powerful political force throughout the early 1970s.[30] This antitax populism was largely an expression of grassroots resistance organized by non-politicians and directed at the formal political system. But in many cases, the antitax sentiment is orchestrated from above by politicians who use the theme to secure office for themselves and their party. Many candidates expose antitax rhetoric to get elected; few run, and fewer still get elected on the slogan of raising taxes. This lesson was learned all too well by presidential candidate Walter Mondale who told his supporters at the 1984 Democratic Convention of his sincere belief that taxes would need be raised in coming years—and was thereafter trounced in the general election by antitax Republican Ronald Reagan.

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[28] For an account of Kasich's position, see Jonathan Chait, "Honest John," *The New Republic* (July 13, 1998), pp. 22-25.

[29] Rubin, *supra*, at p. 30.

[30] Susan B. Hansen, *The Politics of Taxation: Revenue Without Representation* (New York: Praeger, 1983); David O. Sears and Jack Citrin, *Tax Revolt: Something for Nothing in California* (Cambridge: Harvard University Press, 1982).

In the post-war era, antitax themes have been particularly strong in the national political arena, especially within the Republican Party. After World War II, the GOP and its business constituency found a hospitable political climate to pursue an antitax campaign. Reducing the steep wartime tax rates still in place was the dominant Republican issue in the 1946 elections. Republicans candidates campaigned for a 20 percent overall cut in income tax rates. Republicans succeeded with this theme and took control of both chambers of Congress for the first time since 1930. The new Republican leadership in Congress then sought to implement broad tax cuts. The Democratic Truman administration strongly and persistently opposed any such tax cuts. Three times Truman vetoed Republican tax bills. The compromise bill that finally became law, the Revenue Act of 1948, lowered the maximum individual income tax rate to 82 percent from the historic wartime high of 94 percent.

During the 1980s, antitax politics again became a potent force within the Republican Party. During the presidential campaign of 1980, Ronald Reagan endorsed a tax-rate-reduction proposal introduced in 1977 by Senator William Roth and Representative Jack Kemp. The Kemp-Roth proposal had called for a 33 percent reduction in individual tax rates and a lesser reduction in the corporate rate. In the spring of 1981, newly elected President Reagan introduced his own legislative proposal for tax rate reductions styled on Kemp-Roth. Reagan's proposal ran into opposition from congressional Democrats. However, by midsummer 1981 the new president brought together a bipartisan conservative congressional coalition to enact the Economic Recovery Tax Act of 1981. While the 1981 tax cuts were less than those proposed under Kemp-Roth, they still constituted at the time the most significant tax rate reductions in the history of the federal income tax—reducing the maximum marginal tax rate for individuals to 50 percent from 70 percent (roughly where it had stood since the Kennedy tax cuts enacted in 1964). During the second Reagan administration, the maximum marginal tax rate for individuals was further reduced to 28 percent under the historic Tax Reform Act of 1986.

The antitax rhetoric expressed by Reagan Republicans during the 1980s has resurfaced as a powerful force in the Republican Party in the 1990s. Following their success in the 1994 mid-term elections, Republicans took control of both chambers of Congress for the first time since 1954. A strong antitax-wing of the GOP emerged in control of the House. Following the GOP landslide in 1994, Representative Bill Archer (R.-Tx.) was appointed chairman of the House Ways and Means Committee and instigated a campaign to repeal the income tax altogether. Ever since, Archer has repeatedly expressed his contempt for the federal income tax: "I personally would like to tear the income tax out by its roots and throw it overboard." Archer favors replacing the income tax with some form of consumption-based tax similar to a European-style Value Added Tax (VAT).

The most politically viable proposal for replacing the income tax surfaced even before the 1994 elections. Representative Richard K. Armey (R.-Tx.), House majority leader in the 104th and 105th Congresses, introduced a proposal for a flat tax. Under Armey's proposal, a 17 percent tax would be imposed on the wages of an individual in excess of relatively high standard deductions and generous dependent allowances. None of the traditional deductions of the current income tax system would be allowed. Business activity would be taxed at the same rate, with a deduction allowed for wages paid. Thus, the tax on individuals would be progressive to the extent that average tax rates rose in proportion to the individual's income, and the overall tax

base would be consumption (rather than income) because the return on capital investment would not be taxed. Armey's flat tax is virtually identical to the broad-based consumption tax proposed over a decade ago by Stanford University academics Alvin Rabushka and Robert Hall.[31]

In the fall of 1997, the antitax-wing of the GOP turned against the agency charged with administering the tax laws—the Internal Revenue Service. Tapping what they perceive to be a strong undercurrent of antitax sentiment, Republican leaders focused popular discontent with the tax laws on the IRS. Out on the campaign trail, Republican politicians took to blaming the IRS for the excessive complexity of the tax laws (dubbed the "IRS Code") and the burden of taxation itself—conveniently ignoring that it is Congress that writes the tax laws, and not the administrative agency. In September 1997, Senate Finance Committee chairman William Roth (R.-Del.) conducted televised committee hearings investigating alleged abuses of taxpayers by the Internal Revenue Service. In dramatic testimony, IRS agents (some wearing hoods to conceal their identities) testified before the Finance Committee on the alleged abusive conduct of the agency in its collection activities. The hearings were a great public relations success for antitax Republicans, who viewed the publicity as the first step in a full assault on the income tax itself. Soon after the hearings, the Ways and Means Committee approved a bill proposing new safeguards for taxpayers litigating with the IRS and restructuring the Internal Revenue Service (by putting the agency under the control of an independent supervisory board made up of non-governmental executives). The bill sailed through the House in early November 1997 by a vote of 426 to 4, but then was held up in the Finance Committee by Roth—who promised that the Senate would adopt an even tougher version in 1998. In the spring of 1998, Roth again held Finance Committee hearings into alleged abuses of taxpayers by the IRS, but this time there was a much less enthusiastic response from the media and public. Soon thereafter, the GOP proposal to restructure the IRS was adopted under the Internal Revenue Service Restructuring and Reform Act of 1998.[32]

While still only a minority within their own party, members of the antitax-wing of the Republican Party have attracted much attention for their cause and organized a viable national political movement against the income tax. In the 1990s, antitax politics also has been particularly successful at the state level—with 27 states enacting tax reduction legislation in 1997 alone. With publisher Steve Forbes contemplating again entering the GOP presidential primaries in the year 2000 (having campaigned in 1996 on his own version of the flat tax) and Ways and Means Committee chairman Archer on a speaking engagement across the country in early 1998 to "educate" the public on the need to replace the income tax (whether with a flat consumption-based tax or a national sales tax, championed by Rep. Billy Tauzin of Louisiana), the antitax message of the Republican Party continues to dominate the tax policy agenda. For example, in an act of political grandstanding in June 1998, the House voted 219-209 in favor of the Tax Code Termination Act (H.R. 3097, sponsored by Rep. Steve Largent of Oklahoma and

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[31] Alvin Rabushka and Robert E. Hall, *The Flat Tax* (Stanford, Calif.: Hoover Institution Press, 1985, 2nd. ed. 1995).

[32] The House passed the Conference Committee report to H.R. 2676 on June 25 by a vote of 402 to 8, and the Senate followed on July 9, by a vote of 96 to 2. President Clinton signed the bill into law on July 22, 1998.

co-sponsored in the Senate by Majority Leader Trent Lott), which would "sunset" the federal income tax by July 4, 2002. The bill left completely unanswered the rather important question of how to replace the $1 trillion or so of revenue raised annually under the income tax. Apparently, the House leadership counts on the integrity of the Senate (i.e., Finance Committee chairman Roth) to deal with such matters as fiscal responsibility and kill the measure. The point of adopting such a bill in the first place (knowing full well that the Senate would defeat it) was simply to promote the GOP campaign for fundamental tax reform.[33] Overall, the Washington press corps reacted with a good deal of cynicism—and the public with considerable indifference—to this overtly political use of the legislative power.

The antitax rhetoric of the GOP imposes significant restraints on all policymakers—even Democrats who might otherwise be tempted to raise taxes for the federal government. Indeed, there has been enormous political pressure on all politicians in the United States to *reduce* taxes even in the face of the significant budget shortfalls experienced in the 1980s and 1990s—a lesson learned all too well by Bill Clinton. President Clinton was forced to offer his own tax-cut proposals in an effort to quiet the thunder of Republicans in the wake of their significant electoral successes in the 1994 midterm elections, during which antitax rhetoric again ran rampant. Later, Clinton sheepishly disavowed his own 1993 tax legislation to the extent it raised taxes (which it did—on those taxpayers with incomes above $250,000). Later, the Democratic president gave in and accepted a proposal from congressional Republicans for $95 billion of net tax cut over five years. These were included in the Taxpayer Relief Act of 1997 and the Balanced Budget Act of 1997, both signed into law by President Clinton on August 5, 1997.

The persistence of this deep-rooted antitax ideology has had a significant impact on the development of tax policy. Ironically, while broad-based tax reduction is a fundamental tenet of the Republican Party, and cutting marginal tax rates is dogma to the pro-investment, supply-side wing of the GOP, all such tax cuts run counter to what is most advantageous to congressional policymakers *qua* politicians—namely, tax cuts targeted to constituents. As much as Republican politicians like cutting taxes in general, they (and their Democratic colleagues) have a greater interest in granting tax relief to constituents in their home districts and those organized interests and groups that comprise their respective party coalitions. This helps explain why the 1995 Republican tax bill (vetoed by President Clinton), the tax legislation enacted in 1997, as well as the July 1998 tax act—for all the antitax rhetoric—included so many special tax preferences benefiting constituents of *both* political parties.

Pluralism, Incrementalism, and the Income Tax

How then to explain the complex politics of taxation in the United States? Pluralism is the most common model advanced by political scientists to generally describe American politics. The pluralist model assumes that policymaking is decentralized, political power is widely dispersed within civil society, and the apparatus of policymaking is readily accessible to

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[33] For an account of the politics behind the provision to repeal the tax code, see Ryan J. Donmoyer, "In Election-Year Gambit, House Votes to Scrap Code," 79 *Tax Notes* 1533-34 (June 22, 1998).

numerous social and economic interests. Pluralist theory holds that policymakers are subjected to pressures from a wide range of organized groups. Those groups and interests most intensely affected by particular issues will organize and lobby policymakers hardest with respect to those issues. On different issues, different groups and interests are most intensely affected and most vocal in support of their positions. Overall, congressional policymakers respond by enacting policies that accommodate the best organized and strategically situated interests—those with access to the institutions of decision-making. Policy decisions are the outcome of bargaining among those groups that are organized and so represented in the decision-making process. Pluralist power structures tend to produce a distinctive politics to the extent that numerous interest groups potentially possess the power to influence specific and narrow aspects of policymaking, but no single group is capable of dominating the entire policymaking process.

The politics-as-usual of taxation is generally portrayed as typical of a pluralist politics. Indeed, the pluralist model is highly descriptive of policymaking for the income tax during most of the twentieth century. The pluralist model focuses upon Congress and the tax committees and assumes that a dynamic interest-group politics drives tax policy. Groups organized around narrow economic interests and lobby for relief from the relatively high marginal tax rates that have prevailed since the 1940s. Policymakers respond to the appeals of special interests (especially those located in their own home districts) for special tax preferences. Political scientist David Truman took as given that well-financed special-interest groups with a great stake in outcomes will prevail in the tax legislative arena.[34] In the politics of the income tax, outside interest groups (both public and private) have ready access to the policymaking process. As a result of the openness of the congressional policymaking process, the preferences of many competing interests are successfully translated into tax policy. Many of the institutional barriers that congressmen relied upon in the 1950s and 1960s to shield themselves from the pressures of interest groups (most particularly, the centralized control of the tax legislative process in the hands of Wilbur Mills, longtime and powerful chairman of the House Ways and Means Committee), were weakened by the post-Watergate reforms enacted in the mid-1970s. This had the unintended effect of exposing members to greater lobbying and pressures exerted by special interest groups. In the 1980s, the tax policymaking process became even more receptive to interest group politics. Indeed, it seemed that during the decade policymakers accommodated, at one time or another, virtually every organized interest group with their own special tax provisions.

The normal pluralist politics usually results in a process of incremental development for the income tax. Pluralist structures of political power tend to produce incremental policymaking as interest-group pressures most often lead to incremental modifications of existing policies. As such, the pluralist/incrementalist model has been successfully applied to describe the normal policymaking of the federal income tax.[35] Tax policy is said to advance through incremental or

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[34] David Truman, *The Governmental Process,* 2d ed. (New York: Knopf, 1971), pp. 361, 422.

[35] The pluralist/incrementalist model was developed, refined, and applied to the politics surrounding the 1986 tax act in Timothy J. Conlan, Margaret T. Wrightson, and David R. Beam, *Taxing Choices: The Politics of Tax Reform* (Washington, D.C.: Congressional Quarterly Press, 1990), pp. 230-35.

gradual departures from existing law—rather than through radical advances. According to one astute observer of U.S. tax policy: "The tax code offers a variety of easily grasped levers. In this sense, it is an incrementalist paradise, susceptible and seductive to political tinkerers."[36] In incremental policymaking, special provisions enacted for organized interests and groups are preserved in the tax laws, while new policies (very often at cross-purposes with old ones) are continually added.

This model explains a good deal about how the tax laws develop and why the tax expenditure budget increases each year. It also helps explain why tax policy is incoherent, with many provisions in the tax code expressing policies that are in conflict with other provisions. Congress enacts a provision that bestows special tax treatment on a favored group or interest, and then (perhaps reflecting a change in the party in control of Congress) enacts other provisions favoring diametrically opposed interests. The result is that some provisions benefit labor and others business—with both finding a home in the tax code. Occasionally, Congress is pressured by public opinion and media reports to enact provisions designed to limit a taxpayer's ability to make use of these special tax credits and deductions. For example, the alternative minimum tax was created to ensure that those taxpayers who make use of the overly generous tax preferences pay some income tax. Rather than repeal the original preferences, congressional policymakers found it more advantageous politically to enact new complicated provisions to restrict the benefits derived from those preferences—thereby giving the appearance that Congress was doing something about "special interests" without actually taking a position adverse to those interests. This is typical of the pluralist tax politics that prevails in the United States.

Notwithstanding the descriptive power of the pluralist/incrementalist model, it does not explain all of the politics and development of the federal income tax—especially that witnessed in recent decades. Partisanship and ideology have resurfaced as strong, even dominant forces shaping contemporary tax policy. This was the case when supply-side economics dominated tax policy in 1981, when Democrats in 1993 passed by the slimmest of margins a 10-percent surtax on taxpayers with the highest income, and again in 1995 when antitax Republicans took control of the tax committees. In these cases, political ideologies dominated the tax-policymaking process, producing policies very much at odds with what would be predicted by the incrementalist/pluralist model. While the normal politics of the income tax (e.g., use of the tax code for constituency service) is well described by the pluralist model, the most important tax legislation enacted in recent decades expresses a political use of the income tax by policymakers to advance their partisan agendas. Non-incremental tax policymaking has become commonplace in the past two decades.

Certainly, the most difficult tax legislation to explain from the perspective of pluralism and incrementalism is the Tax Reform Act of 1986. In his January 1984 State of the Union address, President Reagan called upon the Treasury Department to produce a study of tax reform. In response, Treasury generated a series of tax reform proposals. For tax experts in Treasury, "reform" means eliminating all the special tax expenditures that Congress inserts into

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[36] John F. Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985), p. 245.

the tax code for political reasons. Unexpectedly, the political movement for tax reform gained in momentum, and Congress reluctantly took up the cause. Eventually, the White House and the tax committees were occupied for nearly two years with the campaign for tax reform. Even more surprising, the effort bore fruit in the fall of 1986 with the enactment of the Tax Reform Act of 1986.

The Tax Reform Act of 1986 has been widely hailed as the most significant tax-reform legislation in the history of the federal income tax.[37] By virtue of the sheer volume of the revisions and amendments to the tax laws that it implemented, the 1986 act was the most massive restructuring in the eighty-year history of the federal income tax. For this reason alone, the 1986 act is impossible to explain from the perspective of pluralism and incrementalism. What accounts for such a dramatic departure from politics-as-usual for the income tax? Some have described the 1986 act as the product of unusual circumstances and the extraordinary convergence of ideas and political interests.[38] In a distinctly unique moment in political time, conservatives and supply-siders in the Reagan administration favoring tax rate reduction found common ground with liberal Democrats in Congress who supported the reform proposals of tax experts in the Treasury Department. Likewise, politicians who normally were not in the vanguard of the tax reform movement (in particular, then Ways and Means Committee chairman Dan Rostenkowski and Senate Finance Committee chairman Robert Packwood) were swept along by the tax reform movement as they feared being perceived by the public as obstacles to reform.

Whatever the merits of this description of the politics behind the 1986 act, it remains difficult (if not impossible) to predict when political interests, reform efforts, and “ideas” will again converge to produce a tax reform bill. Tax reform disappeared from the policy agenda after 1986. Nevertheless, the repeated political use of tax expenditures creates new pressure for tax reform. Eventually, the complexity of the tax laws and the revenue loss attributable to the increase in tax expenditures stimulates interest in pruning and simplifying the tax code. But when, and under what circumstances are such reform efforts likely to succeed? Such radical departures from the normal politics of the income tax lie outside the pluralist/incrementalist model.

A good deal of the politics surrounding the 1997 tax bill can be explained by the pluralist/incrementalist model. Existing provisions were amended and modified at the margins (e.g., changing the tax rate and holding period for capital gains, reducing the impact of the alternative minimum tax on corporations, etc.) to produce slightly better tax results for constituents of the Republican Party. Through trade-offs and compromises, the Democratic administration secured perks of its own—e.g., tax credits for education, phased-out for high-income taxpayers. Overall, the resulting legislation expresses the partisan rhetoric of the GOP,

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[37] John F. Witte, “The Tax Reform Act of 1986: A New Era in Tax Politics?” 19 *American Political Quarterly* 438 (1991), Daniel Shaviro, “Beyond Public Choice and Public Interest: A Study of the Legislative Process As Illustrated by Tax Legislation in the 1980s,” 139 *University of Pennsylvania Law Review* 1, 5 (1990).

[38] Conlan, Wrightson, and Beam, *supra*; John W. Kingdon, *Agendas, Alternatives, and Public Policies,* 2d ed. (New York: Harper Collins, 1995), pp. 213–17.

includes some concession provisions for Democrats, mostly loses revenue and therefore, includes some revenue raisers required under the 1990 budget act. The 1997 tax act also added significantly to the complexity of the income tax by introducing many new and complicated concepts and computations to the tax laws. However, even while Congress was considering this bill that added to the complexity of the tax code and conferred so many tax benefits on the constituents of both political parties, political rhetoric against the income tax ran rampant. Highly partisan proposals for "fundamental tax reform" (meaning, repealing the income tax altogether) continue to attract unexpectedly strong support in Congress. At times, it appears that another dramatic departure from the typical pattern of pluralist tax politics and incremental development is just over the horizon.

The recently enacted Internal Revenue Service Restructuring and Reform Act of 1998 also expresses both partisan rhetoric and incremental policymaking. The initiative emerged from committee as typical of the grab-bag tax legislation enacted in recent years as Republicans succeeded in turning the IRS restructuring measure into an omnibus tax bill.[39] The central features of the IRS reorganization plan is a new organizational structure for the IRS based upon classifications of taxpayers (individuals, corporations, tax-exempt entities, etc.—rather than the old geographic, regional organization in place since 1952) and the creation of a new independent oversight board. The IRS oversight board is comprised of nine individuals: (1) six "private-life" members who are not federal employees or federal officials, and who are appointed by the president, (2) the Treasury secretary, (3) the IRS commissioner, and (4) a full-time federal employee appointed by the president with the advice and consent of the Senate. The authority of the board is limited to administrative and management issues, and is expressly barred from participating in the development or formulation of federal tax policy.

The legislation also included several new taxpayer protections (i.e., provisions expressing the wrath of the GOP for the IRS): provisions to shift the legal burden of proof to IRS in civil litigation, impose limitations on the power of the IRS to levy a taxpayer's principal residence, provide a more favorable computation of the amount of interest owed by taxpayers on unpaid tax liabilities, and limit the liability of an "innocent spouse" for taxes owed by their spouse on a joint tax return. The bill also created a new privilege for accountants representing taxpayers in tax matters.[40] The Conference Committee subsequently modified this privilege, limiting its scope to client representation in civil tax matters before the IRS (but not other government agencies, such as the SEC) and expressly holding that privilege shall not apply in written communications with the taxpayer concerning "corporate tax shelters." As the wording of the bill originally seemed to also apply to the privilege of lawyers representing their clients, the American Bar Association (ABA) joined the American Institute of Certified Public Accountants (AICPA) in lobbying against the measure. Thereafter, the Conference Committee inserted

[39] See Greg Hitt, "Lawmakers Strike Deal on IRS Overhaul," *Wall St. J.*, June 24, 1998, p. A2.

[40] These provisions are described in detail in Robert Manning and David F. Windish, "The IRS Restructuring And Reform Act: An Explanation," 80 *Tax Notes* 83-123 (July 6, 1998).

language making clear that the lawyer-client privilege was not impacted by the provision, and only applies to the already limited new accountant's privilege.[41]

In a provision added at the last minute in Conference Committee, the 1998 act legislation altered the holding period for long-term capital gains that had been adopted only the year before under the 1997 tax act.[42] During the final stages of negotiations over the 1997 bill, at the insistence of Treasury Secretary Richard Rubin, the holding period for the new preferential 20% rate for long-term capital gains was raised from 12 months to 18 months. This created a complicated three-tier system under which gains were taxed at three different rates, depending upon the applicable holding period, as well as the classification of the underlying capital asset itself. On 1997 returns, tax professionals and taxpayers alike found the system a nightmare of complexity. Ways and Means Committee chairman Bill Archer had promised to repeal the 18-month holding period, and he kept his word in the 1998 legislation. Repeal of the 18-month holding period carried a cost of $2 billion over ten years.[43]

Archer also attracted attention when he blocked inclusion of a "technical correction" to the 1997 tax act. The drafters of that legislation had inadvertently altered the tax rate structure for the federal estate tax, and thereby reduced the tax burden for those few wealthy individuals with estates greater than $20 million. Archer rejected the technical correction on the grounds that it would implement a "tax increase" and hence, had no place in the bill. Democrats in Congress were apoplectic. House Minority Leader Richard Gephardt (D-Mo.) denounced Archer's maneuvering to kill the technical correction an "abomination," and Senate Minority Leader Thomas Daschele (D.-S.D.) fumed. But in the end, silence from the White House left congressional Democrats dangling and undercut Democratic opposition in the Conference Committee; the 1997 inadvertent estate tax cut stood.[44]

The 1998 tax act was notable for several other provisions that did *not* make it into the final legislation. The influence of special interest is often evidenced as much by those provisions that are excluded from a tax bill as by those that are included in the legislation for their benefit. For example, the White House had proposed revenue-raising provision that would have changed the way life insurance companies calculate reserves, regulated the use of family limited partnerships in reducing federal gift and estate tax liabilities, and eliminated the use of so-called Crummey powers in planning for the gift and estate taxes. All of these reform measures, which

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[41] The political bargaining over the 1998 tax bill is described in Ryan J. Donmoyer, "Loaded-Up IRS Restructuring Bill Awaits Senate Approval," 79 *Tax Notes* 1663-66 (June 29, 1998); Sheryl Stratton, "Accountant-Client Privilege: Unclear From the Start," 80 *Tax Notes* 7-9 (July 6, 1998).

[42] For an account of how the reduction of the holding period for capital gains was included in the IRS restructuring bill, see Richard W. Stevenson, "Break in Capital Gains Tax Is Added to I.R.S. Overhaul," *N.Y. Times*, June 24, 1998, p. A1.

[43] Joint Committee on Taxation, "Estimated Budget Effects of Internal Revenue Service Restructuring and Reform Act of 1998," June 24, 1998 (JCX-51-98).

[44] The story of Archer's opposition to this technical correction is found in David E. Rosenbaum, "A Mistake Prevails, as Certainly as Death and Taxes," *N.Y. Times*, June 24, 1998, p. A21.

had their origins in the Treasury Department, faced strong opposition from well organized business interests—most particularly, the insurance industry. Congressional Republicans succeeded in excluding all three proposals from the final bill. In addition, a proposal to expand the IRS's electronic filing program via the dissemination of software for tax return preparation was squashed by lobbying efforts from industry giants Inuit Inc. and H&R Block Inc.—which market their own highly profitable software programs for tax return preparation. Issuers of tax-exempt bonds challenged by the IRS were given added protections and a new appeals procedures in an amendment introduced by Senator Orin Hatch (R.-Utah) for the benefit of a school district in his state that had its bonds challenged by the IRS.[45]

A Treasury proposal to tax employer-provided meals was opposed by lobbyists for the gaming and hospitality industries, and a greatly watered-down version was substituted (at a cost of $316 million over 10 years, as estimated by the JCT). In fact, the final version of the bill actually provides more favorable tax treatment of employer-provided meals than that afforded under pre-1998 law.[46] Finally, it was notable that the 1998 bill failed to include even modest relief from the so-called marriage penalty. This issue became a central theme of social conservatives who were enraged to discover that some married couples (e.g., those in which one spouse has a high income and the other a low income) would pay greater income tax filing on a joint tax return than they would if they were unmarried individuals with the same incomes filing separately. (The reason for this result is the progressive tax rate structure that puts the joint taxpayers into a higher marginal tax bracket.[47]) Separate legislation is expected later in 1998 to take on the marriage penalty.

Funding for the many revenue losers included in the 1998 tax act (which the Joint Tax Committee scored as costing $13 billion over ten years) was achieved largely through two measures. The first liberalizes the rules for converting a traditional IRA into a new Roth IRA for senior citizens earning more than $100,000. (The conversion raises revenue in the short-run because tax is triggered on the withdrawal of savings out of the traditional IRA; however, in the long-run, the conversion costs the Treasury as the funds reinvested in a Roth IRA are afforded a more favorable tax treatment. The long-term cost of the conversion shows up outside the 10-year framework of federal budgeting.) The second major revenue raiser overturned the much criticized decision of the U.S. Tax Court in *Schmidt Baking Co. Inc.*[48] In that case, the tax court

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[45] Greg Hitt, "IRS Bill, Poised for Senate Approval, Also Has Benefits for Special Interests," *Wall St. J.*, July 9, 1998, p. A20.

[46] House Ways and Means Committee member John Ensign (R.-Nev.) was successful in slipping into the IRS restructuring bill a proposal that he had introduced in the House in May. That bill, the Worker Meal Fairness Act of 1998, was co-sponsored in the Senate by Speaker Newt Gingrich (R.-Ga.). For an account of Ensign's lobbying, as well as the impact of the provision, see Amy Hamilton, "IRS Reform's Flying Circus—Tales of One Last-Minute Change," 80 *Tax Notes* 145-51 (July 13, 1998).

[47] For a comprehensive explanation and historical account of the marriage penalty, see Michael J. Graetz, *The Decline [and Fall?] of the Income Tax* (New York: W.W. Norton, 1997).

[48] *Schmidt Baking Co. Inc.*, 107 T.C. 271 (1996).

had allowed the company to deduct more than $2 million of accrued (but unpaid) vacation and severance compensation that was secured by a standby letter of credit. Legislative repeal of *Schmidt Baking* was projected to raise some $3.2 billion over 5 years.[49]

In a separate legislative initiative during the spring of 1998, the Education Savings and School Excellence Act of 1998 (H.R. 2646), congressional Republicans proposed expanding tax-free IRA withdrawals for qualified educational expenses—including tuition for private elementary and secondary schools. The bill passed both houses and emerged from Conference Committee in June. However, President Clinton threatened to veto the bill (despite having sponsored the educational tax credits included in the 1997 tax act), and as the Republican leadership lacked the requisite votes to override such a veto, the measure subsequently stalled.

It remains to be seen whether the 1997 and 1998 tax acts herald a return to the normal politics of the income tax, or whether these are merely sideshows on the road to "fundamental tax reform." Both bills express highly partisan politics (mostly Republican) while at the same time serving the bipartisan interests of congressmen in protecting constituents and dominant interest groups in their districts. For this reason, many of the provisions in these tax bills can be explained by the pluralist/incrementalist model. However, the ideological impulses behind the legislation are outside the model. Likewise, the even more radical plans favored by Messieurs Archer and Armey have no place in the pluralist/incrementalist model. Of course, the big question is: Will proponents of any of these radical tax plans ever succeed in the legislative arena? To date, these radical tax plans have provided some opportunities for grandstanding, but their proponents have had very little concrete impact on tax policy. Most likely, in the foreseeable future, tax policy is likely to continue as a mixed bag—some tax pork-barrel, some special interest provisions, and much political bluster. This characterized the 1997 and 1998 tax legislation. Because the tax laws are used not only to raise revenue, but also to implement the partisan agendas of the two national political parties, contemporary tax policy (even during times of peace and prosperity) is simply too complex, unstable, and erratic to be explained by a single model such as pluralist/incrementalism.

Conclusion

The U.S. tax laws are used by policymakers for a variety of political purposes. These are dictated by the constitutional structure of the American regime. Under the democratic electoral system, it is *politicians* who make tax policy. Congressional tax policymakers serve as ombudsmen for their constituents, as well as leaders of the national political parties that control Congress. On top of this, the same policymakers are charged with raising the enormous revenue required to finance the activities of the U.S. government. The revenue function of the income tax is at odds with the instrumental, political uses of the tax.

The structures of the political system impose conflicting demands upon tax policymakers—impelling them *both* to raise revenue and implement policies that are functionally

[49] Joint Committee on Taxation, "Estimated Budget Effects of Internal Revenue Service Restructuring and Reform Act of 1998," June 24, 1998 (JCX-51-98).

equivalent to direct budgetary expenditures. When the income tax is used by policymakers to implement public policies and to cull favor with local constituents, the Treasury is inevitably deprived of revenue. On top of all this, a strong antitax ideology pervades American politics—most typically given voice by the Republican Party. At various moments, such as in the late 1940s and early 1980s, this antitax rhetoric prevails in the political contest between the two major parties. The electoral victory of the Republican Party in the 1994 elections was driven by this antitax ideology. This has altered the dynamics of the tax-policymaking process in favor of tax reductions—perhaps, one day even leading to the abandonment of the income tax altogether. But even those politicians who rant and rave most against the income tax find it irresistible for their own political purposes. Many of the same politicians who voted in June 1998 to sunset the income tax also voted that very same month to enact new tax preferences—for example, education tax credits and special treatment of capital gains.

This all suggests that the income tax will be around for a long while, continuing to serve as the primary source of revenue of the federal government, an important political tool of U.S. policymakers, as well as the object of ideological scorn for politicians intent upon grandstanding for the party faithful. Likewise, it should be expected that Congress will continue to enact tax legislation that expresses all the various imperatives behind tax policy. The next omnibus tax bill will undoubtedly include (like its predecessors) provisions that raise revenue, as well as those that give it away. Some tax preferences will be targeted at distinct and separate economic or political interests in the home district of powerful members of Congress; others will implement broad national public policies. That is the nature of contemporary tax legislation. And unfortunately, the result is a tax policy that is incoherent, erratic and unprincipled.