

# TAX LAW REVIEW

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**WGL**

WARREN GORHAM LAMONT

# Tax Reform: The 1980's In Perspective

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## I. INTRODUCTION

In 1986, Congress, with the strong support of President Reagan, enacted what has been called the most significant tax reform legislation in the history of the federal income tax.<sup>1</sup> It has since become dogma that this legislation, the Tax Reform Act of 1986,<sup>2</sup> was guided by the tax reformist's vision of the ideal tax universe.<sup>3</sup> In the aftermath of the 1986 Act, academic analysis has focused upon an explanation of why tax reform succeeded the way it did and at precisely that particular time. Perhaps the more appropriate question is why the 1986 Act and other legislation should be referred to as "tax reform" in the first place. Once a bill is so characterized, it takes on a special aura, suggesting that it is beyond and above politics. Tax reform is viewed as the triumph of neutral policymaking over the "politics as usual" that is assumed to dominate the tax legislative process. Yet, this term really offers remarkably little in classifying tax legislation, and, often, its very meaning, as used by its proponents as well as scholars of the federal income tax, remains elusive.<sup>4</sup> Indeed, many of the positions most commonly taken to be reformist have inherent political implications that belie the notion that reform is dictated by some neutral science of public policymaking. Furthermore, the various positions most often associated with tax reform, when taken together, can be mutually contradictory, and even worse, actually can have negative implications for some of the most fundamental principles

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<sup>1</sup> The publisher of a popular account of the Tax Reform Act of 1986 boldly states on the book's jacket that: "The Tax Reform Act of 1986 was the single most sweeping change in the history of America's income tax." Jeffrey H. Birnbaum & Alan S. Murray, *Showdown At Gucci Gulch* (1987). Despite the hyperbole, this description of the 1986 Act is essentially accurate.

<sup>2</sup> Pub. L. No. 99-514, 100 Stat. 2085.

<sup>3</sup> See, e.g., Timothy J. Conlan, David R. Beam & Margaret T. Wrightson, *Tax Reform Legislation and the New Politics of Reform* (Sept. 1988) (unpublished paper delivered at 1988 Annual Meeting of the American Political Science Association) [hereinafter *Tax Reform*].

<sup>4</sup> Even such an observant scholar of federal tax as the late Joseph A. Pechman could write an entire study of tax reform without providing a clear concept of why any particular proposal should be classified as tax reform, rather than as simply a proposal to shift the incidence of a particular tax to a different set of taxpayers. See George F. Break & Joseph A. Pechman, *Federal Tax Reform: The Impossible Dream?* (1975).

of the Anglo-American liberal political tradition—most notably, liberty, privacy and the rule of law.<sup>5</sup>

Most sophisticated commentators who have analyzed the 1986 Act and the political dynamics that led to its enactment have stressed the confluence of an extraordinary series of events and interests that made possible the unpredicted success of this comprehensive tax reform package.<sup>6</sup> Indeed, it has become commonplace to hold that those particular events and circumstances were so distinct and peculiar as to suggest that tax reform in 1986 was a political aberration, a sudden departure from politics as usual in the world of tax policymaking. Politics as usual in tax policy most often is described by reference to “interest group politics,” “pluralism” or the “incremental” policymaking which generally is said to characterize American domestic politics. Because of this, the 1986 Act, which so clearly contradicts and stands outside the pluralist/incremental paradigm<sup>7</sup> of tax policymaking, needs to be explained away as an aberration, lest the entire model be revealed as somehow incomplete or inadequate. Furthermore, it is generally true that since 1986, tax policymaking has resembled more closely the old style of politics as usual than the tax reformism manifested by the 1986 Act. The attempt to explain away the 1986 Act makes sense in many ways.

What is acutely missing from even the most sophisticated explanations of the 1986 Act and the politics of tax policymaking is the recognition that tax reform is itself a truly ambiguous concept, one that carries with it considerable, although not necessarily coherent, ideological baggage. This contrasts with the common view that tax reform is some abstract, objective and scientific vision of “good” tax policy, one that for various reasons happens occasionally to find a political audience, for example, in 1986, during a rare alignment of the legislative and executive branches. Given the infrequency of such a convergence and alignment of political

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<sup>5</sup> When used in this context, “liberal” or “liberalism” broadly refers to the Anglo-American tradition of political thought emphasizing the priority of individual rights over the interests of state and society, with state action subject to legal constraints (i.e., the rule of law). This tradition, firmly rooted in the American experience, is associated most often with the seminal political writings of the English philosopher John Locke. See Louis Hartz, *The Liberal Tradition in America* (1955); F.A. Hayek, *The Constitution of Liberty* (1960).

<sup>6</sup> See John F. Witte, *The Tax Reform Act of 1986: A New Era in Tax Politics?* 1 (Oct. 1990) (unpublished manuscript prepared for the Annual Meeting of the American Political Science Association) [hereinafter *New Era*] (“[I]t is most likely that the act is a combination of epiphenomenal events and reactive legislation . . . .”); Timothy J. Conlan, Margaret T. Wrightson & David R. Beam, *Taxing Choices* 1 (1990) [hereinafter *Taxing Choices*] (“Especially in political terms, the TRA was little less than a modern miracle.”).

<sup>7</sup> Thomas S. Kuhn, *The Structure of Scientific Revolutions* 43-51 (1962). Kuhn’s theme is that communities of scientists and scholars have embraced divergent beliefs about the nature of reality, the problems raised by such beliefs and the proper way to investigate such problems. Kuhn refers (in somewhat imprecise detail) to such a set of beliefs as a “paradigm.” For a brief description of Kuhn’s theory and its impact upon the social sciences, see David M. Ricci, *The Tragedy of Political Science* 190-205 (1984).

interests, tax reform is seen as an extraordinary departure from the normal pattern of political events.

Many of the problems with most contemporary analysis of the federal income tax can be traced to this untenable assumption that those policies conveniently lumped together under the rubric of tax reform are something other than the expression of a particular political perspective, one that has its own agenda, favoring certain interests over others, and with its own constituency that derives considerable political satisfaction and benefits from success in the political arena. Tax reformism is political by nature precisely because *any* change (whether designated as reform or otherwise) to existing political institutions and extant legal structures has distinct political implications. The adoption of any significant change to the tax law constitutes a political act. Indeed, the very decision to adopt an income tax is a political decision of the highest order. Those who characterize those diverse changes to the Code that were enacted in 1986 as tax reform are implicitly adopting the false dichotomy that there are "good" changes (those designated as tax reform which pursue the public interest and somehow rise above politics) and "bad" changes (those which favor special interests and are the product of politics). This untenable classification permeates contemporary analysis of the politics of tax policy.

The pretense underlying this conceptual framework ultimately denigrates the political process. It presupposes that the traditional congressional policymaking process is "corrupt" to the extent it is tainted by politicians and interest group politics, while genuine tax reform constitutes that rare triumph of reason and the pure science of tax policymaking. Such sentiments betray a utopian longing for the day when tax academics will leave the universities and think tanks and take over the reins of the Treasury Department, and perhaps the membership of the House Ways and Means and Senate Finance Committees as well. Presumably, when that happens, tax reform no longer will be a mere aberration or departure from politics as usual, as it was in 1986. Instead, rational policymaking finally would supplant politics as usual.

There is no denying that a tax code drafted by the experts in Treasury or tax academics in our law schools and think tanks would be more coherent, rational and perhaps even more just, compared to a code drafted by a congressional committee exposed to the pressures of lobbyists retained by the most significant interest groups congregating in Washington. And, no doubt, tax policy made by academic tax experts would provide a more rational structure to the excruciatingly intricate complexity of the tax code. But that is too simplistic a view of what is implied by the concept of tax reform. Indeed, a tax code drafted by tax experts or

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academics very likely would turn out to be much more complicated precisely to the extent that it purports to be more "fair."

As I hope to show, tax reformism (which I take to be the ideological commitment to amend the federal tax laws to conform with a very precise academic vision of the ideal income tax) has its own inherent political agenda, and itself is informed by a very particular expression of politics within the broader sphere of domestic policy. While not all of what is commonly referred to as tax reform fits into a single ideological mold, the many different expressions of tax reformism (for instance, the academic movement for a comprehensive tax base, the attack upon loopholes and tax expenditures, and even the current appeal for tax simplification) all share an underlying disdain for the political process even while purporting to be neutral vis-à-vis tax policy and the tax laws. But particular groups and interests inevitably benefit from the enactment of "reforms" of the tax code, while others are affected adversely. When all is said and done, rather than taking tax policy out of politics, with all its susceptibilities to the distortions of the public interest inflicted by interest group pressures, tax reformism merely shifts tax policymaking to a different political arena, one dominated by tax experts and bureaucrats, rather than by Senators, Representatives and their staffs.<sup>8</sup>

A whole set of political choices follows from the adoption of the reformists' agenda. While these underlying political choices seldom are articulated by the proponents of tax reform, tax reformism has clear and distinct implications for those political institutions within which policy is made, as well as for the broader political community. And, to adopt many of the proposals commonly referred to as tax reform is, in many ways, to compromise those democratic and representative political institutions and processes through which domestic policy traditionally has been molded and shaped into public law. This traditional politics emerged in the early nineteenth century and represents the fusion of eighteenth century constitutional structures with the nascent nineteenth century extra-constitutional political party system.<sup>9</sup> It is precisely this system of party, congressional committees and constitutional process that reformism takes as its target.

Tax reformism is mostly at the expense of the tax committees of Congress. This is because congressional committees are viewed by reformers

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<sup>8</sup> Congressional staffs are a recent phenomenon and must be distinguished from the administrative agencies, even though they both may include so-called "tax experts." For a general discussion of the rise and role of congressional staff, see Michael J. Malbin, *Unelected Representatives* (1980).

<sup>9</sup> Indeed, American political institutions were borrowed from the English constitutional tradition, took root here, and "were given new life precisely at the time that they were being abandoned in the home country." Samuel P. Huntington, *Political Order in Changing Societies* 96 (1968).

as overly susceptible to interest group pressures and their members are condemned as too prone to follow their own electoral interests by enacting social pork barrel tax policies for the benefit of their constituents. Ultimately, such a position results in throwing out the baby of republican constitutionalism with the bathwater of special interests. Whatever the lofty intentions of its proponents, reform of the traditional tax policymaking process inevitably results in less rulemaking by elected representatives and more by the administrative elite. One should not forget that to the extent Congress and the tax committees no longer make tax policy, it nonetheless will be made elsewhere. Administrative agencies and bureaucrats will replace (and in the post-New Deal administrative state, to a great extent, already have replaced) Congress as the de facto locus of power, if not the de jure source of authority, as rulemaking shifts from the traditional political arena to the experts entrenched in the bureaucratic state.<sup>10</sup> This is a choice that some ultimately may prefer. But, it is surely a political choice, and one that should be subjected to close public scrutiny and debate on its merits.

Once tax reformism is recognized as encapsulating a political vision of how, where and by whom tax policy is to be made, the implications of its adoption are more readily apparent. Likewise, more significant questions then can be raised. What are the implications for domestic policymaking when the Code is "reformed?" What is the outcome of specific "reforms," such as closing tax "loopholes" or abolishing tax "shelters?" How are individual taxpayers (ultimately, the citizens comprising the political community) and their rights and liberties affected by an increasingly complex system of tax laws, regulations and rule by bureaucrats (tax experts)? Are there limits to how far the tax administrative state should intrude into the lives of individual taxpayers (including corporations and businesses), even at the expense of forgoing some additional sources of revenue and violating cardinal principles of an ideal tax code? These are the kinds of broader political and philosophical questions that should be considered before waxing too sentimental over tax reform and before turning over policymaking to the tax experts.

When tax reformism is recognized as the pursuit of a specific political agenda, its success in 1986 (and retrenchment in subsequent years) can be seen in much the same light as any other political victory, and not as some mystical event resulting from the once-in-a-generation convergence of political interests. Tax reformism, much as Reaganism, the Great Society or even the New Deal, marked the triumph of a particular political agenda, one that achieved a limited temporal victory in American electo-

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<sup>10</sup> See generally Jeremy Rabkin, *The Judiciary in the Administrative State*, *Pub. Interest*, Spring 1983, at 62; James Q. Wilson, *The Rise of the Bureaucratic State*, *Pub. Interest*, Fall 1975, at 77-103.

ral politics in 1986. Just as with any other political agenda, tax reformism does not necessarily represent a coherent or cohesive set of ideological claims. Despite this, the 1986 Act undoubtedly will have some lasting impact upon tax policy and, perhaps in lesser ways, upon the very structure of our political institutions. Over time, however, its success inevitably will be eroded as the still entrenched old style of politics reasserts itself. Tax reformism may continue as a viable force in American politics, and may again play an important role in the formation of tax law, but its "triumph" could no more translate into the end of politics than could the success of any other political agenda.<sup>11</sup>

For most of this century, tax policymaking has been a dynamic political process involving the interaction and attempt to prioritize and satisfy many different, often contradictory, political and economic interests. The old style of politics as usual is very much a process of ordering and accommodating diverse and often mutually exclusive interests. This style of tax politics will not end or be supplanted absent a complete triumph of the administrative state. Nor will it again dominate, absent the entirely unlikely return to the pre-New Deal order of parties, Congressmen and committees. Given the hybrid American state that has developed in this century, with its administrative agencies grafted onto the traditional institutions and processes, tax policy undoubtedly will continue to find its origins in both the administrative state, where tax experts make policy, and in traditional electoral politics, characterized by representatives, tax committees and interest group pluralism. These very different sources of tax policy will continue to compete for domination over tax policy, but neither is capable of attaining hegemony in the foreseeable future. As a consequence, there will and can be no coherent, complete or ideal tax code. Although tax reformism periodically will reassert itself and compete for its place on the political docket, it will never be able to achieve any lasting "triumph" over tax policy.<sup>12</sup> Tax policy will remain at odds with itself as it is driven by, and reflects, two competing and inimical sources of policy initiatives.

## II. THE CONCEPT OF TAXATION

Attempting to define tax reform, as well as purporting to establish the "purpose" of the federal income tax, is presumptuous at best. Yet, any

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<sup>11</sup> Use of the word "triumph" is common in describing the success of reformism in 1986. See, e.g., Conlan et al., *Taxing Choices*, note 6, at 186. A more appropriate analysis would recognize that the relevant question is whether the passage of the 1986 Act represented an aberration or the emergence of a wholly new pattern of reformist politics. In this respect, the triumph of reformism would represent a more modest event than the end of politics itself.

<sup>12</sup> The reference is to the common assertion that reformism periodically "triumphs" over the old style "politics as usual," for example, the special interests that otherwise dominate politics. See text accompanying note 11.

understanding of the nature of tax reformism and its impact upon tax policy requires familiarity with the principles of taxation. The concept of taxation must be the starting point for any analysis of the various manifestations of reformism directed at the federal revenue laws.<sup>13</sup>

In the most simplistic sense, taxation is simply one among many means available to a centralized government to raise revenue for funding its own spending and attaining fiscal self-sufficiency. In this respect, the coercive nature of taxation is its most salient feature. While generally the liberal regime is constrained internally by its own notions of legitimate state action which thereby define the parameters of such forms of state finance,<sup>14</sup> the various fiscal options available to Western democratic regimes nonetheless are considerable.<sup>15</sup> The range of methods available to the liberal state to raise revenue, and accordingly, to determine which groups will bear the actual economic burden, make decisions regarding the incidence and structure of a system of taxation, in the end, political decisions of the highest order.

Indeed, in the past, the American polity has made such fundamental political decisions as to how to fund the central state. For instance, the late eighteenth century constitutional period represented the culmination of a decade of dissatisfaction with the Articles of Confederation as an economic, political and military framework for the national state apparatus.<sup>16</sup> The Constitution, as adopted in 1789, provided, among other things, enhanced means by which the national government could raise revenue without the need to rely upon the constituent state governments comprising the confederacy. While the Constitution and the nascent system of political parties that developed by the early nineteenth century later proved to be inadequate to cope with the political pressures emergent in the post-Civil War era, the traditional system of state finance (i.e., the tariff) was still quite capable of supporting the financial needs of the reconstituted national government.<sup>17</sup> Until World War I, the tariff re-

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<sup>13</sup> I ignore here the marginal movement which champions the outright abolition of the federal income tax. It is neither reformist in nature (the very notion of which implies ameliorative changes within the framework of the existing legislative process), nor likely to have any serious impact on American politics in the foreseeable future.

<sup>14</sup> See generally Alan Wolfe, *The Limits of Legitimacy* (1977), and James O'Connor, *The Fiscal Crisis of the State* 203-20 (1973).

<sup>15</sup> Presumably, imperialism, colonialism and/or territorial expansion are no longer viable options for any regime as the final decades of the century witness the "end of history," although recent events in the cradle of civilization suggest that not all of the world of nations has yet reached the stage of development prophesized by Francis Fukuyama in *The End of History?*, *Nat'l Interest*, Summer 1989, at 3, 3.

<sup>16</sup> The argument that the adoption of the stronger federal structure of the Constitution over the looser confederacy of the Articles was motivated by military and economic considerations is found in William H. Riker, *Federalism* (1964).

<sup>17</sup> See generally Stephen Skowronek, *Building A New American State: The Expansion of National Administrative Capacities, 1877-1920* (1982). The discussion here relies heavily



mained the most significant source of revenue for the federal government<sup>18</sup> and provided the symbol for some of the most intense political conflicts in the post-Civil War era. The abandonment of the tariff and the political battle culminating in the adoption of the federal income tax in 1913<sup>19</sup> as the new (and soon-to-be primary) source of revenue proved to be a watershed event in the development of public finance, as well as a milestone in the development of the national political party system.<sup>20</sup> Ultimately, decisions as to how a polity should finance its public spending reveal as much about the character of the regime as how it chooses to spend the revenue.<sup>21</sup>

Of course, it is commonly asserted that taxation of the citizenry by the central government involves much more than just raising revenue.<sup>22</sup> The power to tax provides a ready, albeit crude, means for public control over private behavior through a combination of economic incentives and disincentives permitting the state to alter, and thereby shape and manipulate, social and economic activity.<sup>23</sup> Under basic assumptions about human behavior, understood well before the formal advent of the "dismal science" itself, taxing a commodity results in higher prices, which in turn dampens desire for and consumption of that product, and makes other alternative and substitute goods more competitive. Likewise, taxing individual behavior, whether social or economic, results in corresponding changes in that behavior.<sup>24</sup> This exercise of the power to tax

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upon Skowronek's provocative account of the development of the American administrative state.

<sup>18</sup> See John F. Witte, *The Politics and Development of the Federal Income Tax* 79 (1985) [hereinafter *Politics*] ("Prior to World War I, over 90 percent of federal revenues came from either excise taxes or customs . . . . [T]he war virtually ended the importance of the tariff as a source of revenue and greatly diminished the role of excise taxes . . . .").

<sup>19</sup> Revenue Act of 1913, Pub. L. No. 63-16, ch. 16, 38 Stat. 114, 166-81.

<sup>20</sup> Immediately following his election, Woodrow Wilson pushed for reduction in the tariff and adoption of an income tax. Earlier support for an income tax was strongest within the Populist movement. Witte, *Politics*, note 18 at 76.

<sup>21</sup> One can only ponder the implications of such revenue-raising schemes as those enacted by state governments in recent years to fund educational programs and medical benefits for the aged through the use of state-sponsored bingo, million-dollar lotteries, or even, in the case of Nevada and New Jersey, public gambling parlors.

<sup>22</sup> See, e.g., Joseph A. Pechman, *Federal Tax Policy* 5 (5th ed. 1987) ("Taxation is a major instrument of social and economic policy. It has three goals: to transfer resources from the private to the public sector; to distribute the cost of government fairly . . . and to promote economic growth, stability and efficiency."); see also Break & Pechman, note 4, at 4.

<sup>23</sup> See generally Charles E. Lindblom, *Politics and Markets: The World's Political-Economic Systems* (1977).

<sup>24</sup> The increases in the so-called luxury and vice excise taxes enacted in 1990 appear to presuppose a virtually inelastic demand curve for the goods taxed. Ultimately, the fallacy of this assumption will be recognized as predicted revenues fail to materialize. This much may have been acknowledged by Office of Management and Budget Director Richard Darman who announced that the Bush administration would not oppose repeal of the luxury tax because it raises only a small amount of tax and even may be "counterproductive." Darman Says Administration May Support Repeal of Certain Portions of Luxury Tax, *Daily Tax Rep.* (BNA)

allows for a significant degree of public control over the allocation of goods and services that would otherwise result from the unrestrained expression of human desires, as moral or immoral as they may be.<sup>25</sup> In this way, taxation serves a fundamentally political role as it shapes the character of the civic culture and economy of a regime.

One of the most significant achievements of Anglo-American liberal politics has been to create a structure for governmental institutions that effectively constrains the state's ability to impose arbitrary controls over economy and society. In the liberal state, tax policy (as well as domestic policy in general) has operated within the broader parameters of liberal political sentiments, generally respectful of liberty and individual rights, and bound by the principles of the rule of law.<sup>26</sup> It is this liberal tradition of politics governed by the rule of law that is threatened most directly by developments in tax policy in the past decades.<sup>27</sup> In fact, as I shall argue below, aspects of so-called reform actually often further trends inimical to those principles most fundamental to the liberal political regime. Those trends include an increased complexity in the tax laws that undermines the possibility of the rule of law, the intrusion of the tax administrative state into the private lives of individuals and the business decisions of private business enterprises, thereby altering and misdirecting the formation of capital, and generally furthering the disenchantment and bureaucratization of the private sphere.<sup>28</sup> As the tax

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No. 117, at G-3 (June 18, 1991). Repeal of the luxury taxes would represent a departure from the general tendency to "reform" a failing tax structure (for example, one that allows taxpayers to avoid its impact) by applying the tax to even more taxpayers or, in this case, sales of tangible personal property.

<sup>25</sup> Even ardent supporters of an unfettered private market economy recognize the inherent tendency of free markets to appeal to "demands" that may be lacking in moral virtues. See, e.g., Irving Kristol, *Two Cheers for Capitalism* ix-xiv (1978). The third cheer is withheld on account of the amoral character of free market societies.

<sup>26</sup> For the classic account of the rule of law, see Hayek, note 5, at 162-75.

<sup>27</sup> A popular account of the abusive nature of the Service in implementing the federal tax laws is David Burnham, *A Law Unto Itself: The IRS and the Abuse of Power* (1st Vintage Books ed. 1989). However, the reader should be skeptical of this journalist's portrait of the Service as a law enforcement agency out of control. Burnham relies upon a typical journalistic approach in focusing upon a few horrifying cases of the "abuse of power." He displays little recognition of the substantial literature on the development of and problems associated with large-scale bureaucratic social organization, and offers no insights into how the modern nation-state can apply complicated laws and regulations under the rule of law while respecting the liberty and privacy of its citizenry.

<sup>28</sup> The features of a tax system necessary to preserve a stable economy, as well as to respect the liberties of individuals, have been summarized as follows: "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. . . . The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality . . . is not near so great an evil as a very small degree of uncertainty." Adam Smith, *The Wealth of Nations* 778 (New York: Modern Library, 1937).

laws become more complex (often directly attributable to implementing some ill-conceived reform), citizens are reduced to taxpayers who are forced to become part-time accountants and recordkeepers.<sup>29</sup>

### III. THE CONCEPT OF TAX REFORMISM

Taxation entails more than just neutral state action in raising revenue, and inevitably implies an attendant theory of social and economic policy. For this reason, any theory of tax reform also presupposes its own theory of social and economic policy. Tax reform is more than just fiscal fine-tuning or the neutral refinement of the revenue laws. Indeed, for its proponents, tax reform represents something of a ritualistic cleansing of corruption from the tax laws. In many ways, reformist sentiments betray the legacy of the Progressive era, with its fixation upon the amelioration of public policy through the exposure of corruption and abuse.<sup>30</sup> The other side of reformism is its unyielding faith in science and expertism as the tools of a neutral science of public policy. This is the Progressive's obsession with experts who will administer the state free of politics and its resulting corruption of the public interest.<sup>31</sup> Together, the twin-edged sword of tax reformism is the attempt to sweep privilege and corruption out of the Code and to replace interest group politics with neutral policymaking informed by a science of public policy as made by the experts in the administrative state.

In its most recent incarnation, in the post-Watergate politics of the mid-1970's, reformism prescribed "sunshine" and "openness" as the medicine necessary to purify the political process. This sentiment found its way into the tax policymaking process as well.<sup>32</sup> Recent critics have

<sup>29</sup> As Moses Herzog put it in one of his great and insightful observations about modernity: "Internal Revenue regulations will turn us into a nation of bookkeepers. The life of every citizen is becoming a business. This, it seems to me, is one of the worst interpretations of the meaning of human life history has ever seen. Man's life is not a business." Saul Bellow, *Herzog* 11 (1964).

<sup>30</sup> See Richard Hofstadter, *Anti-intellectualism in American Life* 197-229 (1962); Richard Hofstadter, *The American Political Tradition* (1948); Richard Hofstadter, *The Age of Reform* (1955); Samuel P. Huntington, *American Politics: The Promise of Disharmony* 89-129 (1981); Christopher Lasch, *The World of Nations, The Moral and Intellectual Rehabilitation of the Ruling Class* 80-99 (1973).

<sup>31</sup> See, e.g., Samuel P. Hays, *Conservation and the Gospel of Efficiency: The Progressive Conservation Movement 1890-1920* (1959). For a discussion of the "professionalization" of political science and the study of politics, see Ricci, note 7, at 3-25; Dorothy Ross, *The Origins of American Social Science* 149, 252, 318 (1991).

<sup>32</sup> For instance, in 1973, the House adopted a rule stating that:

[E]ach meeting for the transaction of business, including the markup of legislation, of each standing committee or subcommittee thereof shall be open to the public except when the committee or subcommittee, in open session and with a quorum present, determines by rollcall vote that all or part of the remainder of the meeting on that day shall be closed to the public.

characterized this particular expression of reformism as reflecting a naive and utopian politics.<sup>33</sup> "Reforms" were enacted and political structures were altered, often with inadequate thought given to the practical implications upon the functioning of such delicate political institutions as the House Ways and Means and Senate Finance Committees as well as the whole legislative process by which tax law is made. Openness and sunshine themselves do not provide for a coherent vision of politics and, if forced upon a political system, may actually turn out to have unanticipated and even wholly undemocratic effects upon political institutions. Political institutions can be closed internally, even autocratic, and yet be democratic and open at the highest systemic level.<sup>34</sup> Similarly, internally undemocratic institutions may actually enhance public-interested policymaking. For instance, closed markups of tax legislation by the House Ways and Means Committee actually result in more public-interested tax law, not less.<sup>35</sup>

But, for the committed reformist, politics is only the struggle to realize an ideal vision of the tax laws. Accordingly, tax reformism shows a perplexing obliviousness to the inherently political nature of all changes to extant legal structures. By "inherently political nature," I mean that any change in institutions, procedures and existing legal structures inevitably has repercussions on the political, and even upon the very nature of a particular regime. Once the underlying political assumptions and implications of tax reformism are drawn out, its implicit political agenda is more evident and its many apparent inconsistencies can be resolved. Conversely, by adhering too rigidly to a notion of tax reform as the pur-

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H.R. Res. 259, 93d Cong., 1st Sess. (1973).

<sup>33</sup> The best discussion of the post-Watergate reform of the House tax committee is Randall Strahan, *New Ways and Means* 53-90 (1990). Strahan has concluded that: "Contrary to the hopes of reformers, according to most committee members the change to open committee markups in the mid-1970s tended to strengthen the pull of the electoral connection as members often felt pressured to stake out uncompromising positions when working under the watchful eye of representatives of local interests or groups who were electoral allies (or potential enemies)." *Id.* at 173; see also Conlan et al., *Taxing Choices*, note 6, at 105. For a more sympathetic view of these reforms, see Rob Bennett, *The Open and Shut Case of Tax Bill Markups*, 49 *Tax Notes* 1375, 1376 (Dec. 17, 1990).

<sup>34</sup> The argument that democratic institutions are defined by competition for political leadership among elites representing political parties (which may be entirely undemocratic internally) was stated by Joseph A. Schumpeter in *Capitalism, Socialism, and Democracy* 269-83 (1942).

<sup>35</sup> See Pamela Fessler, *Panel Expects to Rewrite Tax Code in Private*, *Congressional Q. Wkly. Rep.*, Aug. 31, 1985, at 1706 (the "dilemma for liberal reformers" was to admit that "the best [tax bills] have come out of closed sessions."). Randall Strahan concludes: "It is difficult, if not impossible, to isolate the effects of closing markup sessions. However, interviews with committee members suggest that the return to closed sessions may have reduced the influence of particular interests and clientele groups in committee decisionmaking and may have also encouraged members to take a broader view of the issues at stake in recent tax legislation." Strahan, note 33, at 144.

suit of neutral principles dictated by an abstract science of public policy, inconsistent and incoherent political positions are pulled together under the banner of reformism.

The weakness of much of the analysis of tax reformism is derived directly from the inherently flawed conceptual premises of academic theories of the federal income tax itself. The problem lies in the supposition that the first principles of taxation are based upon objective standards enunciated by economics and the science of public policy analysis. Quite to the contrary, the first principles of an income tax necessarily express inherently normative political positions. The very decision to adopt an income tax, whatever its structure, is a fundamental decision of the polity. The structure of the tax, once adopted, determines how the citizenry will bear the economic burden of the tax, and accordingly, invokes the most fundamental political issues.

Among academics, questions relating to how the income tax is to be structured commonly are said to initially require a decision whether the tax rate is to be progressive, regressive or flat. Likewise, given a particular tax rate structure, derivative normative questions revolve around the decision as to what income is to be taxed (and conversely, what income is to be exempt) and what kinds of expenditures should be allowed as an offset or deduction to taxable income. Beyond this, intense political conflict results from the use of the Code to stimulate investment and allocate capital to carry out certain public policies. Of course, the latter decisions typically are the result of logrolling and interest group politics, rather than broad national policy initiatives.

The tendency among academic theorists of the income tax, especially those in the law schools, is to deny or obfuscate the political and normative dimensions of these first principles of an income tax. For instance, it is commonly asserted that an income tax should be evaluated by reference to two fundamental principles of tax fairness—so-called vertical and horizontal equity.<sup>36</sup> Horizontal equity is taken to mean that all income, regardless of its source, should be treated comparably—presumably, taxed. Vertical equity purportedly “demands” that those with more in-

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<sup>36</sup> These principles have been expressed in classic textbook fashion as follows:

One important goal of a good system of income taxation must be *fairness*. . . . The principle of horizontal equity is that people similarly situated should be taxed alike, which is translated under an income tax into the principle that people with the same income (properly defined) should pay the same tax . . . . Vertical equity refers to the relative amounts of taxes paid by people with different incomes. The rate structure of our income tax reflects the adoption of a principle of vertical equity called *progressivity*, which means that as one's income rises the *proportion* of income that one pays as a tax rises.

William A. Klein, Joseph Bankman, Boris I. Bittker & Lawrence M. Stone, *Federal Income Taxation* 19-20 (1990); see also Conlan et al., *Taxing Choices*, note 6, at 26; Michael J. Graetz, *Federal Income Taxation: Principles and Policies* 17 (2d ed. 1988).



come should be taxed at a higher marginal tax rate. This is to say that the structure of tax rates must be progressive in order for the tax to be respected as fair.<sup>37</sup> Putting forth such simplistic normative propositions as the first principles of taxation, and couching them in the purportedly neutral language of pseudoscientific terminology, ignores the extent to which these propositions are inherently political in nature.<sup>38</sup> When stripped of the pretensions, such propositions should be recognized as presupposing a very distinct political ideology, one subject to significant disagreement.

For instance, there are several problems with the kind of analysis which presupposes vertical and horizontal "equity" to be the neutral, first principles of an income tax. First, there is the entirely casual reference to "fairness" which betrays a fundamental intellectual dishonesty. Such usage, ubiquitous in legal discourse, suggests that the concept of "fairness" is self-evident and has a settled and shared meaning.<sup>39</sup> This effectively avoids the need for argumentation and political discourse on the underlying issue.<sup>40</sup> The appeal to fairness serves to end all debate as to the principles of vertical or horizontal equity, and intimates that any objection to vertical and horizontal equity is implicitly to favor an "unfair" income tax. Second, once these principles are taken as axiomatic, it follows that tax policy itself must be judged by the extent to which it conforms with these principles of fairness. Thus, if the structure of a tax is "fair" only if it is progressive, then anything that defeats the progressivity of the tax must be overcome. Tax deductions that serve to lessen the progressive impact of the rate structure are assumed to be abusive loopholes, while legislation aimed at eliminating loopholes and subjecting all sources of income to tax (thus promoting horizontal equity) is deemed to be "reform," regardless of its political implications.

In fact, within the broader political community there is remarkably little consensus as to these principles of vertical and horizontal equity and how they dictate the structure of the federal income tax, or any other tax for that matter. Regressive taxes, for example, most sales and employment taxes, flourish in clear violation of vertical equity, and yet apparently are not abhorrent to the body politic. On the contrary, the

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<sup>37</sup> Conlan et al., *Taxing Choices*, note 6, at 26 n.21 ("[A]ccording to [the principle of vertical equity], fairness is a matter of progressivity: treating unequals differently; that is, taxing the wealthiest more."). In contrast, a regressive tax (and therefore a bad tax, to most theorists) does the opposite, taking a larger fraction of lower incomes.

<sup>38</sup> More perceptive students of the income tax acknowledge the "perennial and unrelenting controversy" surrounding the concept of vertical equity. See Break & Pechman, note 4, at 3.

<sup>39</sup> For an attempt to define fairness, see Victor Thuronyi, *The Concept of Income*, 46 *Tax L. Rev.* 45 (1990).

<sup>40</sup> "Fairness" is considerably more difficult to define as an ethical norm than lawyers often would have us believe. See, e.g., John Rawls, *Justice as Fairness: Political Not Metaphysical*, 14 *Philosophy & Pub. Aff.* 223 (1985).

significant political successes in the last decade by proponents of a flat (or flatter) tax rate—which include the passage of the 1986 Act itself—suggest that vertical equity and progressive tax rates may not be part of the public philosophy.<sup>41</sup> While departures of practice from public values obviously are fair game for any serious critical analysis of public policy, one should be more cautious about positing one's own normative goals as the reification of "equity."

A lack of public commitment to vertical equity and progressive tax rates was underscored vividly, if unintentionally, by Senator Daniel Patrick Moynihan of New York when he focused attention on the "regressive" structure of the Social Security tax imposed upon wages and the income of the self-employed.<sup>42</sup> Senator Moynihan emphasized the unfairness of the structure of this tax, but failed to generate any groundswell of indignation among legislators or the electorate, many of whom presumably are wage earners who actually pay the tax.<sup>43</sup> The electorate was neither shaken from its (perhaps irrational) commitment to the program nor offended by the regressive way in which the revenue that finances the program is raised. The whole episode suggests that the ideal of vertical equity may be more a tenet of the tax academic community than of the broader political community.<sup>44</sup> Nevertheless, this conception of tax reformism as the pursuit of vertical and horizontal equity is at the heart of the tax expert's vision of the tax code.<sup>45</sup>

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<sup>41</sup> One of the first academic statements in favor of a flat rate tax which was widely read and perhaps helped to stimulate the movement for tax reform in 1986 was Alvin Rabushka & Robert E. Hall, *Low Tax, Simple Tax, Flat Tax* (1983). The casual way in which "reform" became almost synonymous in 1985 with lower and flatter tax rates also suggests that progressive taxes are not necessarily associated with equity in the popular image.

<sup>42</sup> Although the wage tax is imposed technically at flat rates, it is commonly referred to as a "regressive" tax. The tax has two elements: an Old-Age, Survivors, and Disability Insurance tax (OASDI) and a Hospital Insurance Tax (HI). The OASDI tax is 6.2% and is imposed on only the annual wage base, which in 1991 is the first \$53,400 of wages. The HI tax is 1.45% and is imposed on the first \$125,000 of wages. Thus, there is a regressive rate structure of three brackets: a tax of 7.65% on the first \$53,400, a tax of 1.45% on the next \$71,600, and 0% on wages above \$125,000. See IRC §§ 3101, 3121(x).

<sup>43</sup> The question of the "fairness" of the structure of the wage tax must be distinguished from any analysis of the program itself as a social security or retirement/insurance policy. For the latter, see Martha Derthick, *Policymaking for Social Security* (1979).

<sup>44</sup> In mid-January 1991, Senator Moynihan reintroduced his plan to cut the FICA wage tax and return the Social Security program to "pay as you go" financing. The proposal would have cut the tax rate, but raised the wage base subject to the tax, thereby softening somewhat the regressive structure of the tax. See Tim Gray, *Moynihan Plan Resurrected; Bentsen Pledges Quick Action on Filing Extensions for Troops*, 50 *Tax Notes* 215 (Jan. 21, 1991). Ultimately, this bill was defeated by the Senate in April 1991, and the issue appears to be buried, at least for the foreseeable future. See *Senate Closes Door on Consideration of Social Security Tax Cut Proposal*, *Daily Tax Rep.* (BNA) No. 80, at G-5 (Apr. 25, 1991).

<sup>45</sup> For example, one scholar of tax policy has simply defined tax reform as the pursuit of a comprehensive income tax base, the logical conclusion of a tax system founded upon the principle of horizontal equity:

## IV. DEVELOPMENT OF FEDERAL INCOME TAX

A. *Tax Reformism vs. Incrementalism*

The impact of ideology and tax reformism on the development of the federal income tax has been relatively neglected in the academic tax literature, which has focused instead upon the more familiar story of Congress, congressional committees and interest group politics. Furthermore, the tax literature in many ways has failed to keep up with the insights of social science and historical analysis in constructing a comprehensive theory of the development of the federal income tax.<sup>46</sup> A 1985 study by John Witte<sup>47</sup> has done much to rectify this shortcoming by providing a framework for studying the development of the Code. Nonetheless, considerable conceptual confusion obviously remains as to how tax reformism impacts upon this developmental process. Witte's own scholarship underscores the problem.

In great detail, Witte chronicles the federal government's relentless search for revenue through the income tax. He shows that the rise of the income tax as the primary source of federal revenue, as well as the constant movement toward a broadening of the tax base, strongly correlates with the federal government's need for increased revenue during wartime economies.<sup>48</sup> In other words, war is the midwife of marginal rate increases. Even more significant, Witte portrays the Code as developing through "incremental" policymaking. Congress preserves those special benefits which already have been granted to special interests, and at every opportunity, enacts new ones in response to the almost constant political pressures exerted upon elected political elites.<sup>49</sup> Incrementalism is often

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Experts generally agree which changes in income tax laws are properly labelled as "tax reforms." Those changes reduce or eliminate tax expenditures which are provisions conferring deductions, credits, exemptions, or special timing or treatment of taxable income. Reductions in tax expenditures, all else being equal, produce a broader and more uniform income tax base and a less complex tax system.

Witte, *New Era*, note 6, at 1; see also Joseph Isenbergh, *The End of Income Taxation*, 45 *Tax L. Rev.* 283, 330 (1990) ("At the outer limits of economic income there is, in a region of some abstraction, what could be called the 'universal income tax base.' It includes *all* net enhancements of well-being. . . . If this were the base of taxation, much of the return to consumption that now escapes tax would in fact be reached. . . . A tax on the universal tax base would in fact satisfy simultaneously the elusive goals of efficiency and horizontal and vertical equity.").

<sup>46</sup> Two standard, although somewhat outdated, histories of U.S. taxation up to the post-World War II era are Sidney Ratner, *Taxation and Democracy in America* (1942), and Randolph E. Paul, *Taxation in the United States* (1954).

<sup>47</sup> Witte, *Politics*, note 18.

<sup>48</sup> *Id.* at 128-30.

<sup>49</sup> *Id.* at 3-23. "Incrementalism" holds that policies generally evolve by small incremental departures from existing policies, rather than by radical breaks from traditional policy. As a normative theory, incrementalism stresses the preferability of such marginal changes given the impossibility of comprehending all the contingencies that follow from radical policy experiments. The term may have been first introduced to public policy analysis by Charles E. Lindblom and Robert A. Dahl in *Politics, Economics, and Welfare* (1953). See also Charles E.

portrayed by political scientists as the prevailing descriptive model of tax policymaking, to the extent that it is associated with the pluralistic interest group politics, which is seen as predominant in the United States, both at the local and national levels.<sup>50</sup>

Based upon experience prior to the 1980's, it would be tempting to conclude that tax policy is simply incapable of transcending this incremental policymaking process dominated by interest group politics. Many scholars took just that position, and as a consequence, even such a perceptive scholar of tax policy as Witte ended up missing the mark. Writing in 1985, Witte saw only pluralism, interest group politics and the concomitant incremental policy changes as they impacted upon the development of the tax laws.<sup>51</sup> Based upon his theoretical and professional commitment to incrementalism as a descriptive model of tax policymaking, Witte was led to deny the very possibility of reformist impulses ever succeeding.<sup>52</sup> This prediction of the inevitable defeat of reformism and the triumph of incrementalism was made within three years of the passage of the most dramatic reformist legislation in the history of the federal income tax, reform which enacted the very core of those schemes which were dismissed so readily by Witte as having no chance of passage. As if to compound the error, in an epilogue written in January 1985, Witte was still so encumbered by his intellectual commitment to incremental policymaking that he could only dismiss the already actively sim-

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Lindblom, *The Science of "Muddling Through,"* 19 *Pub. Admin. Rev.* 79-88 (1959). For a general description of Dahl and Lindblom's notion of incrementalism, see Ricci, note 7, at 167 ("By incrementalism, Dahl and Lindblom meant a series of policy adjustments starting from the basis of existing policy, recognizing its advantages and disadvantages, and continuing in small steps via calculated risks, where immediate additions to old policy will not at once achieve all goals but at the same time will not unduly invite unforeseen consequences.").

<sup>50</sup> Pluralism is a descriptive model of the decentralized policymaking structure said to be characteristic of American politics. A pluralistic politics is one in which policy outcomes are the result of bargaining among those groups represented in the political process. As such, pluralism is conducive to incremental policymaking to the extent that many different interest groups have the power to influence specific and narrow policymaking, with no group capable of implementing a wholesale, radical departure from existing policy. The preeminent theorist of pluralism is Robert Dahl. See Robert A. Dahl, *Dilemmas of Pluralist Democracy* (1982); Robert A. Dahl, *Polyarchy* (1971); Robert A. Dahl, *Who Governs?* (1961); Robert A. Dahl, *A Preface to Democratic Theory* (1956).

<sup>51</sup> Witte was not the only one to misperceive the prospects for tax reform. For instance, in 1984, Michael J. Graetz wrote: "[P]rospects for structural tax reform have been dimmed by recent 'reforms' in congressional practices; public pressure to enact income tax reforms seems nonexistent; political leadership on tax matters has become increasingly diffuse. . . . In short, for those who would urge massive tax reforms, there is more than ample cause for despair." Michael J. Graetz, *Can the Income Tax Continue to Be the Major Revenue Source?*, in *Options for Tax Reform* 39, 42 (Joseph A. Pechman ed., 1984); see also David G. Davies, *United States Taxes and Tax Policy* 287 (1986) ("Meaningful [tax] reform, something beyond a multitude of political trades, under present political institutions essentially is doomed to failure.").

<sup>52</sup> Witte, *Politics*, note 18, at 380 ("There is nothing, absolutely nothing in the history or politics of the income tax that indicates that any of these [tax reform] schemes [*i.e.*, Treasury I] have the slightest hope of being enacted in the forms proposed.").

mering tax reform package as having little chance to succeed.<sup>53</sup> Five years after the passage of the 1986 Act, Witte still views it as an aberration or temporary departure from incrementalism, rather than reflecting any long-term structural change in the pattern of tax policymaking.<sup>54</sup>

This is not meant to denigrate Witte's scholarship (which is powerful and impressive) nor even to question his power of prediction (which is less so). Based upon prior experience, as well as the theoretical framework of his analysis, Witte's prediction made considerable sense, even as late as 1985. But any model of political behavior based solely upon extrapolation from past events and trends likely will be inadequate to predict what are, by definition, radical departures from usual experience. And of course, if past behavior allowed for predictions of all future events, the world of politics would be infinitely dull and mechanical, in short, of interest only to social scientists.

The methodological problem that results from focusing too exclusively upon incrementalism in the area of tax policy (and perhaps other areas of domestic policy as well) is that while it may be descriptive most of the time, it is generally blind to those rare bursts of reformist enthusiasm which, although outside politics as usual, nevertheless have had the most significant impact upon the course of the development of the federal income tax. While most often the dynamics of the legislative process are informed by pluralistic politics, this does not represent the complete story, nor are special interests and Congress the only sources of policy initiatives.<sup>55</sup> It is now quite obvious that tax policy reflects more than just the interplay of interest groups and legislators on the tax committees; it does not develop solely through incremental stages. Whether or not this is desirable is an entirely different question, one that should be approached with considerable caution given the experience in the 1980's with dramatic tax legislation.

The impact of tax reformism on the development of the federal income tax reflects its ambiguous nature as a political movement based upon an incoherent ideology, one that denies its own political nature. To the extent that the role of tax reformism is less than fully appreciated, its im-

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<sup>53</sup> *Id.* at 385-86. Witte later made amends for his shortsightedness. See, e.g., Witte, *New Era*, note 6, and John F. Witte, *A Long View of Tax Reform*, 39 *Nat'l Tax J.* 255 (1986).

<sup>54</sup> Witte, *New Era*, note 6, at 20 ("[T]he institutional framework . . . remains and it is difficult to see why actions in the future should necessarily tilt in the direction of tax reform rather than anti-reform.").

<sup>55</sup> The foremost student of bureaucracy, James Q. Wilson, argues that policymaking is very different in different policy areas, and cannot be characterized by a universal description, such as the overly simplistic interest group model discussed below. See text accompanying notes 57-61. Different agencies are subject to different kinds of pressures and have different capacities to resist the lobbying of special interest and broad economic sectors. Likewise, Wilson emphasizes the obvious, but often forgotten point, that bureaucrats often have their own values, preferences and agendas for policy. See James Q. Wilson, *Bureaucracy* 50-71 (1989).



pact upon the development of the federal tax laws accordingly will be underestimated. Reformist impulses constantly shape the development of the federal income tax, both in the dramatic fashion last seen in 1986, and also in more subtle ways as particular provisions of the Code are introduced or amended. Conversely, incrementalism and pluralism may shape the general development of the federal income tax, but they are hardly the only factors at work in dictating the kind of tax laws that ultimately govern such a significant amount of our economic activity.

### *B. The Curious Persistence of the Interest Group Model*

The widespread acceptance of the view that interest groups effectively determine tax policy has done much to erode popular confidence in the fairness of our tax law. To this extent, the public philosophy has embraced a view of the political process which was largely abandoned in the academic disciplines over a generation ago.<sup>56</sup> Indeed, what is most interesting is the widespread persistence of the interest group model of tax policymaking in the face of so much recent contradictory scholarship,<sup>57</sup> as well as the new realities evidenced by the passage of the 1986 Act.<sup>58</sup> The underlying model of interest group politics, while now out of vogue among political scientists, nevertheless remains entrenched among the media, the tax bar and the faculty of most American law schools.<sup>59</sup>

Of course, it should be noted that those who teach in our law schools, the journalists who write about tax legislation and the lawyers who practice (and in most cases who actually write our tax laws), seldom possess firsthand experience or knowledge of academic disciplines such as political science, economics and public policy. Thus, while the understanding

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<sup>56</sup> The classic statement of the interest group/capture theory of agency development typical of a prior generation of scholars is Marver H. Bernstein, *Regulating Business by Independent Commission* (1977); cf. Grant McConnell, *Private Power & American Democracy* (1966).

<sup>57</sup> Paul J. Quirk, *Industry Influence in Federal Regulatory Agencies* (1981); Paul J. Quirk & Martha Derthick, *The Politics of Deregulation* (1985); Skowronek, note 17; Wilson, *Bureaucracy*, note 55; *The Politics of Regulation* (James Q. Wilson ed., 1980).

<sup>58</sup> The persistence of the interest group model of explaining tax policymaking is exemplified by Birnbaum & Murray, note 1. The introduction describes the state of tax policymaking before the 1986 Act as follows: "[M]ost political scientists, lawmakers, and informed analysts were convinced that radical or fundamental change was impossible. Even the first Reagan term produced only a modest amount of really significant change, and second terms traditionally are less productive. Above all, any fundamental change that affected the powerful, growing special interests seemed a political pipe dream. The importance of special-interest campaign contributions caused many to suggest that this was the 'best Congress money could buy.'" *Id.* at xi.

<sup>59</sup> The classic (and highly perceptive) expression of the interest group model as applied to tax policymaking is Stanley Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 *Harv. L. Rev.* 1145 (1957). A recent example of "investigative" reporting is Donald L. Barlett & James B. Steele, *America: What Went Wrong?*, *Phila. Inquirer*, Oct. 20-28, 1991.

of the policymaking process that informs those who write about and ultimately draft our tax laws is based upon extensive practical experience with the details of tax law, it is generally bereft of an informed academic underpinning.

The interest group model of the tax policymaking process crudely reduces the purpose of all tax lawmaking to that of serving or mechanically responding to the pressures exerted by well-organized special interest groups. The underlying theoretical assumption is that wealth, economic size or strategic importance translates into political power.<sup>60</sup>

The problem with the interest group model of tax policymaking (and, hence, any analysis of the tax law resulting from it) is that it leaves no room for the possibility of politics itself. The simplistic notion that wealth and economic power are immediately convertible into political power, and hence translate directly into special tax benefits for their holders, denies the power of ideas and ideology in the political arena and fails to recognize the tendency and ability of groups to organize around principles. Furthermore, and most crucial, it ignores the many ways in which political elites are able to play off competing interests against each other and to organize their own political support in order to achieve a significant degree of autonomy for themselves in the political arena. Likewise, the interest group model focuses too exclusively upon members of Congress and the taxwriting committees as the arena within which tax policy is formed.

For several decades now, academics in political science and public policy analysis have emphasized the notion of the autonomy of political elites in the decisionmaking process. Scholars have focused upon the relative independence of administrative elites, the role of ideas in motivating policy and the importance of political entrepreneurs in shaping and selling public policies that are often radical departures from what would be expected of both political institutions dominated by and subservient to special interests and the kind of incremental policymaking assumed to dominate politics as usual.<sup>61</sup> Yet, practitioners, legal scholars and many

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<sup>60</sup> One of my favorite tax lawyers blindly and annoyingly insists upon explaining every special provision of the tax code as the result of some interest group having had better lobbyists than the other relevant interest groups. Of course, this is a perverse variant upon the interest group model, which treats wealth and economic strength as immediately translatable into political influence capable of molding the tax laws to favor that interest. This lawyer's view seems to presume that the choice of or capacity to hire the right lobbyist is the determining factor. Compare this view with that of Witte, *Politics*, note 18, at 21 ("Thus, rather than arguing that the rich control tax politics, the conclusion of this study is that *no one* controls tax policy and the tendency is for politicians to confer as many benefits on as many groups as is politically feasible.").

<sup>61</sup> See Quirk, note 57; Quirk & Derthick, note 57; Skowronek, note 17; Wilson, *Bureaucracy*, note 55; *Politics of Regulation*, note 57; see also Martin Carnoy, *The State and Political Theory* (1984); Youssef Cohen, *The Manipulation of Consent* (1989); Eric Norlinger, *On the Autonomy of the Democratic State* (1981).

journalists still essentially view tax policy through the narrow perspective of interest group politics.<sup>62</sup>

This is not to say that the impact of special interests in affecting tax legislation should be discounted, but rather that such a view must be incorporated into a broader perspective of the political process by which tax policy is made. Viewing tax policymaking as the transmutation of economic power into public policy badly misconstrues and ignores those elements of tax policy which can be understood only as having their origin in what can be called, for lack of a better term, the "enthusiasm" of tax reform. And, it has turned out that in the previous decade the extraordinary sources of policy (rather than incrementalism) had the most significant and dramatic impact upon our tax laws.<sup>63</sup> Likewise, the interest group model also fails, even within the context of interest group politics itself, to explain why some groups are successful in achieving their goals through tax legislation while others are not. If certain industries and economic sectors are protected by the tax laws, it is not just because they are big, hired the right lobbyist or contributed to the right political action committee. Particular interests can succeed, even without lobbying, logrolling and other political devices characteristic of interest group politics, as ideas, movements and political entrepreneurs set the agenda for debate.

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<sup>62</sup> As if to prove this point, which may appear to be an overstatement, see Barlett & Steele, note 59. The authors won a 1989 Pulitzer Prize for a seven-part exposé of the "special tax breaks" embodied in the 1986 Act and its transition rules. The series, which recently won the 1991 George Polk award for economic reporting, catalogues negative economic trends of the 1980's and blames them all on an evil conspiracy of "special interests," "the powerful and influential" and their "lackeys in Congress" who "write the complex tangle of rules" for their express benefit. It is beyond the scope of this article to critique this massive polemic, which is little more than a series of one-sentence paragraphs asserting the same general and unproven theme that Congress passed every tax statute, bankruptcy law, labor law, for example, for the sole purpose of benefitting "the privileged, the powerful and the influential . . . at the expense of everyone else." *Id.* at Oct. 20, 1991, at A1. If this sounds like an exaggeration merely to provide a strawman for the above argument, the reader is referred to the third part of the series subtitled, *Big Business Hits the Jackpot with Billions in Tax Breaks*, based upon the sole premise that "Congress has stood for the rich" and thus enacted "laws and regulations crafted for the benefit of special interests." *Id.* at Oct. 22, 1991, at A1, A18.

<sup>63</sup> In summarizing his conclusions as to tax reform in the post-Watergate reform era, Randall Strahan has concluded that as to 1975 through 1981, there is little evidence as to increased "particularism and clientelism in Ways and Means Committee deliberations on major tax legislation," and "responsiveness to clientele interests in committee decisionmaking has been very limited since 1981." Strahan, note 33, at 160; see also *id.* at 90 ("Even with institutional changes that increased the importance of clientele groups in the committee's environment, patterns in members' goals suggest only a limited increase in responsiveness to clientele groups.").

## V. THE NEW DYNAMICS OF TAX POLICY

It has been noted that particular arenas of power themselves generate and determine the nature of related policy.<sup>64</sup> The arena within which tax policy traditionally has been formulated is one of congressional tax committees, the members of which are subject to strong political pressures in their home districts. In decades prior to the 1970's, these pressures generally were felt less intensely by members of the tax committees. However, the tight institutional grip once exerted by Wilbur Mills over tax policymaking as chairman of the House Ways and Means Committee (as well as the control exercised by the House Rules Committee) significantly loosened after the mid-1970's.<sup>65</sup> At the same time, legislators who are relatively immune from institutional constraints exerted internally within Congress by the broad-based national political parties have come to be the norm in the world of post-Watergate reforms.<sup>66</sup> Likewise, political parties at the national level have evolved into little more than loose coalitions of locally elected political elites having the same partisan label, but in most ways beyond the control of any central party apparatus, including that of their own leadership in Congress.<sup>67</sup> The effect of these evolutionary reforms upon tax policy, as with public policy in general, has been to further expose policymakers to interest group pressures in the absence of any strong countervailing partisan majoritarian forces.<sup>68</sup>

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<sup>64</sup> Theodore J. Lowi, *American Business, Public Policy, Case Studies, and Political Theory*, 16 *World Pol.* 677-715 (1964); see also Conlan et al., *Tax Reform*, note 3, at 37 ("There is in contemporary American government one system of power revolving around organized and constituent interests, another around presidential elections and parties, and a third around ideas.").

<sup>65</sup> The classic descriptions of Wilbur Mills' control over tax policy and the Ways and Means Committee are John F. Manley, *The Politics of Finance: The House Committee on Ways and Means* (1970), and John F. Manley, *Wilbur D. Mills: A Study in Congressional Influence*, 63 *Am. Pol. Sci. Rev.* 442-64 (1969). An excellent study describing the new directions taken by the Ways and Means Committee since the early 1970's is Strahan, note 33.

<sup>66</sup> The best account of the dynamic relationship between the congressman and his local district is Richard Fenno, Jr., *Home Style: House Members in Their Districts* (1978). Understanding the weakness of congressional party leadership vis-à-vis the individual member of Congress helps to explain the ease by which the October 1990 Budget Summit Compromise was defeated on the floor of the House despite the support of most of the House leadership. See Tim Gray, *Budget Agreement Mired in Political Brinkmanship*, 49 *Tax Notes* 127 (Oct. 8, 1990).

<sup>67</sup> The best general account of how members of Congress pursue their own electoral goals is David R. Mayhew, *Congress: The Electoral Connection* (1974); see also Morris P. Fiorina, *Congress: Keystone of the Washington Establishment* (1977). The general decline of the national political parties is described in James L. Sundquist, *Dynamics of the Party System* (1973), and David S. Broder, *The Party's Over: The Failure of Politics in America* (1972); cf. Larry J. Sabato, *The Party's Just Begun* (1988).

<sup>68</sup> Stanley Surrey wrote pessimistically in 1981: "The consideration of tax legislation by the Congress has completely disintegrated. The picture has been one of almost utter chaos without responsible control residing anywhere. Tax legislation has become a catch-as-catch-can affair that produces complexities, unfairness, conflicting moves in all directions, almost min-

Ironically, the same breakdown of institutional control over the taxwriting committees which opened the door to greater interest group pressures also created an increased opportunity for the success of reformist politics as pursued by "political entrepreneurs." Committee members have become increasingly adept at defining and leading popular opinion as they adopt the role of the political entrepreneur.

Given such a political arena, with all its parochial and regional perspectives, as well as the increased incentives and abilities of congressional incumbents to make use of their powers of office to cater to special interests in order to retain their seats,<sup>69</sup> it is entirely predictable that tax policy would proceed in incremental steps away from the primary goal of raising revenue for public purposes in favor of providing special benefits to the most organized and politically active private economic interests. This broad tendency should and will not surprise anyone familiar with the dynamics of the tax policymaking process. Incrementalism does define politics as usual in the arena of tax policymaking. However, as a result of the congressional reforms implemented in the 1970's, the door was opened to political entrepreneurs and proponents of tax reform to also become major factors in shaping tax policy. In the 1980's, both factors proved to be strong enough to override incrementalism and interest group politics, as tax reform took on a serious urgency all of its own.<sup>70</sup>

#### A. *The Tax Reform Act of 1986*

The role of tax reformism and the ideas of academics in shaping domestic tax policy was demonstrated most clearly during the series of events that led up to the passage of the 1986 Act.<sup>71</sup> In 1985, tax reform-

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dless provisions . . . ." Stanley Surrey, *Our Troubled Tax Policy*, 12 *Tax Notes* 179, 185 (Feb. 2, 1981).

<sup>69</sup> Fiorina, note 67, at 39-49, 56-70. Advocates of "reform" lately have argued in favor of a two-term limit for congressional incumbents. Opponents argue that it makes no sense to force out representatives just as they develop some measure of expertise in their jobs. See Nelson W. Polsby, *Congress-Bashing for Beginners*, *Pub. Interest*, Summer 1990, at 19-20. This is particularly true in regard to the Ways and Means Committee whose members would have even less expertise and experience in the incredibly technical world of tax law. This, in turn, would make them even more dependent upon their committee staff and more vulnerable to the appeals from interest group representatives.

<sup>70</sup> Taxation was not the only policy area in which well-organized special interests were subordinated to "public" interest in the late 1970's and 1980's. Quirk & Derthick, note 61, at 13-17 (a study of a number of policy areas in which Congress supported complacent public interests over entrenched well-organized economic interests).

<sup>71</sup> The best journalistic account of the political events leading up to the passage of the 1986 Act is Birnbaum & Murray, note 1. The best scholarly analysis of the Act is the recent study by Conlan et al., note 6; see also Joseph J. Minarik, *How Tax Reform Came About*, 37 *Tax Notes* 1359 (Dec. 28, 1987); Alvin Rabushka, *The Tax Reform Act of 1986: Concentrated Costs, Diffuse Benefits—An Inversion of Public Choice*, 9 *Contemp. Pol'y Issues* 50 (1988). Less insightful is David Brockway, *The Process Behind Successful Tax Reform*, 31 *Vill. L. Rev.* 1803 (1986).



ism was the single most cohesive force in aggregating a wide array of political interests into a viable political coalition for reform of the Code. Over the years, the Code had been shaped by narrow special interest provisions enacted as successive incremental legislative modifications.<sup>72</sup> Since the Code's last massive overhaul in 1954 (a recodification, rather than a reformation), modifications associated with incremental policymaking have been said to have significantly eroded the Code's revenue raising capacity.<sup>73</sup> Many of those provisions were passed at the behest of politically effective interest groups represented by the lobbyists that came to prominence in Washington during the post-World War II years. Special interest provisions, as well as the increasingly sophisticated and bold schemes put forth by the tax shelter industry, became the object and focus of the reformists' wrath in the mid-1980's. However, contrary to prior experience in the 1960's and 1970's, the reformists actually were effective in 1986 in eliminating or limiting some of the most time-honored "abuses" of the tax laws, such as the real estate tax shelter<sup>74</sup> and the business deduction for the infamous "three martini" lunch.<sup>75</sup> The legislation also curtailed less notorious provisions, such as the completed contract method of tax accounting.<sup>76</sup> More surprisingly, the 1986 Act

<sup>72</sup> "Over the years, in trying to respond to the demands of diverse groups, to meet the needs of decision makers . . . the income tax as a fundamental and ostensibly equitable means of raising revenue has been slowly but continuously eroded." Witte, *Politics*, note 18, at 369. As noted above, this incremental development of the Code reflects the pluralistic structure of political institutions which allows for a maximization of the impact of interest groups on influencing policy outcomes.

<sup>73</sup> "Erosion" of the tax base is the common complaint of those who oppose the various deductions, credits, exclusions from income and special exemptions which reduce the total amount of taxable income subject to the federal income tax. See, e.g., Birnbaum & Murray, note 1, at 13 ("The seventy-three-year history of the income tax had been a steady erosion of the tax base.") This is patently false. The history of the income tax is marked by a relentless movement to broaden the tax base, which itself was the impetus for lobbying for special provisions providing relief from the increasingly high progressive tax rates. The effect is erosion of revenue only if one believes that anyone should actually ever pay 70 cents on the dollar to the federal government as income tax, which was the case when the marginal tax rate on individuals was 70%.

<sup>74</sup> The chief provision attacking tax shelters was § 469 which limited deductions for passive activities.

<sup>75</sup> IRC § 274(n) (deduction limited to 80% of business expense for food). See U.S. Treasury Dep't, *The President's 1978 Tax Program 195-202* (1978).

<sup>76</sup> Congress chose to limit (and later actually prohibited) the use of the completed contract method of tax accounting due to abuses in the defense industries. Staff of Joint Comm. on Tax'n, 100th Cong., 1st Sess., *General Explanation of the Tax Reform Act of 1986*, at 524-30 (Comm. Print 1987) [hereinafter *Bluebook*]. However, this method of tax accounting was also used widely by other industries, most notably the home construction business, which was caught completely off guard by this provision. See Sheldon D. Pollack, *IRC Section 460: Long-Term Construction Contract Issues*, 68 *Taxes* 30 (1990). It also is questionable whether any of the Congressmen and Senators on the taxwriting committees or the conference committee for H.R. 3838, which became the 1986 Act, had any idea as to the meaning of new § 460 (the provision that imposed restrictions upon use of the completed contract method).

eliminated or severely restricted some of the most popular tax "loop-holes" for individuals, such as the deduction for personal interest,<sup>77</sup> the deduction for state and local sales taxes,<sup>78</sup> contributions to Individual Retirement Accounts<sup>79</sup> and deductions for miscellaneous itemized deductions.<sup>80</sup>

These and a host of other special tax provisions, while often portrayed by the popular media as abusive tools of the rich used to avoid their fair share of taxation, in actuality provided tax benefits to a wide economic spectrum of taxpayers, including, and perhaps even disproportionately, the middle class. The widespread availability of many of these provisions helps to explain their popularity and resilience in the face of prior reformist efforts for their elimination. These provisions, as well as many other narrow tax breaks which had crept into the Code with little economic justification beyond lowering taxes for the specific interest groups which benefitted from their passage, were either severely limited or completely eliminated in the crusade for reform which so unexpectedly found success in 1986.

The incremental policymaking which generally is associated with the politics of interest groups must be contrasted with the dramatic tax policies enacted pursuant to the 1986 Act. In turn, tax legislation in 1986 must be distinguished from other major reform initiatives as well as the other tax bills passed during the first term of the Reagan administration. For instance, the Economic Recovery Tax Act of 1981 (ERTA)<sup>81</sup> enacted dramatic legislative changes which lowered tax rates for high income taxpayers, reinstated the investment tax credit, permitted the "sale" of tax losses through so-called safe harbor leases and generally provided for faster tax write-offs for business property through accelerated depreciation.<sup>82</sup> ERTA radically changed the then existing taxation of capital and represented a significant departure from politics as usual qua incrementalism, but it reflected a very different economic agenda, one presumably having as its goal the stimulation of business, manufac-

<sup>77</sup> Pub. L. No. 99-514, § 511, 100 Stat. 2244 (adding § 163(h)).

<sup>78</sup> *Id.* at § 134(a), 100 Stat. 2116.

<sup>79</sup> *Id.* at §§ 1201-3, 100 Stat. 2520.

<sup>80</sup> Certain objects of the reformists' wrath were able to survive even the onslaught of reform, essentially due to political considerations in holding together the coalition for reform. These items include the deduction for state and local income and property taxes as well as the host of provisions favoring labor's vested interest in tax-free fringe benefits, long a favorite preference of Sen. Robert Packwood, chairman of the Senate Finance Committee.

<sup>81</sup> Pub. L. No. 97-34, 95 Stat. 172.

<sup>82</sup> It was estimated that contrary to claims that it would raise revenue, ERTA actually would reduce federal revenues by an amount expected to exceed \$700 billion over five years. See Joint Comm. on Tax'n, 97th Cong., 1st Sess., General Explanation of the Economic Recovery Act of 1981, at 379-80 (Comm. Print 1981); see also Charles E. McLure, Jr., *The Budget Process and Tax Simplification/Complication*, 45 *Tax L. Rev.* 25, 33 (1989).

turing and investment through the use of tax incentives.<sup>83</sup> Reformism was not the driving force behind tax legislation in 1981, but, then, neither was incrementalism.<sup>84</sup>

Enactment of the partisan economic program underlying ERTA was itself possible only by virtue of very specific historical anomalies—namely, the Reagan landslide resulting in a strong Republican presidential coalition as well as a temporary congressional majority which although not necessarily Republican, nonetheless was intent on implementing the same political agenda. Whatever its ultimate economic shortcoming, ERTA can be respected at least for the consistency and coherence in its vision of a particular economic policy. This is more than can be said for the many tax bills which consist of little more than a collection of compromise and often contradictory legislative proposals thrown together in a last-minute desperate attempt to obtain agreement for an overall package. But most important, ERTA could no more be anticipated or explained by the theory of incrementalism than could the 1986 Act.

It goes without saying that the 1986 Act, and, to a lesser extent, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA),<sup>85</sup> had an altogether different political source and ideological vision of tax legislation than did ERTA.<sup>86</sup> But despite these very real differences, what the 1986 legislation had most in common with the other significant tax bills of the 1980's was the extraordinary extent to which their passage signaled a break with and transcendence of incremental policymaking. Indeed, the 1986 Act should be distinguished from other major tax legislation (even those only nominally called tax reform bills) precisely by the way it pursued policies so distinctly adverse to those special interests which political analysts have come to assume control the taxwriting committees.

Thus, incrementalism simply fails to describe tax policymaking in the 1980's. A more promising descriptive model of tax policymaking is one of incrementalism defining "politics as usual," shaping the Code through the dynamic interplay between interest groups and tax pork barrel politics, with the development of tax law marked dramatically by the emergence of volatile partisan and/or ideological majorities enacting major

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<sup>83</sup> See Senate Comm. on Finance, Economic Recovery Tax Act of 1981, S. Rep. No. 144, 97th Cong., 1st Sess. 11-13 (1981).

<sup>84</sup> John Witte is of the view that of all tax bills enacted prior to the 1986 Act, only the Tax Reform Act of 1969 "undeniably qualifies as tax reform." Witte, *New Era*, note 6, at 1.

<sup>85</sup> Pub. L. No. 97-248, 96 Stat. 324.

<sup>86</sup> Witte has noted the irony associated with the fact that Ronald Reagan presided over both ERTA and the 1986 Act: "Ronald Reagan thus has the unique historical position of supporting both the largest tax reform and the largest anti-tax reform legislation in the history of the United States." Witte, *New Era*, note 6, at 6.

tax legislation, with the executive leadership at times playing a significant role in directing such policy initiatives.

What is most curious about tax reform in 1986 is the extent to which it was informed by that abstract vision of the federal income tax long advocated by academic tax experts. The seminal theorist of tax reformism, Henry Simons, provided what has become the classic definition of income for purposes of the income tax and was a strong proponent of a comprehensive income tax base (the cornerstone of horizontal equity).<sup>87</sup> The dominant theorists of tax reformism of the succeeding generation were Stanley Surrey of Harvard University, later Assistant Secretary of the Treasury for Tax Policy, and Joseph Pechman of the Brookings Institution.<sup>88</sup> The enduring vision of tax reform cultivated by Surrey and Pechman can be described best as the credo of vertical and horizontal equity in pursuit of a comprehensive tax base. Their legacy is in their substantial contribution toward defining the orthodoxy of the tax expert: broadening the tax base to include previously excluded or exempt sources of income, eliminating unjustifiable "preferences" and tax "expenditures," reducing erosion of the revenue-raising capacity of the tax laws and other sources of leakages of tax revenue, while simultaneously closing the vast array of special tax loopholes bestowed upon favored special interests.<sup>89</sup> Carried to its logical and consistent conclusion, this vision of tax reform attacks even the most sacred of middle-class tax benefits, such as the deduction for home mortgage interest and the exclusion of social security benefits from income, on the underlying principle that all sources of income should be treated in the same way, that is, be subject to tax.<sup>90</sup>

In 1986, due to an unusual array of circumstances, this abstract vision of tax reform was unexpectedly the theoretical foundation for a political coalition which turned out to have just enough broad-based support to prevail against the typically stronger, more focused special interests. The story of how special interests so often succeed in the political arena of tax policy by exerting intense pressures in regard to those issues most signifi-

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<sup>87</sup> See Henry C. Simons, *Personal Income Taxation* (1938); Henry C. Simons, *Federal Tax Reform* (1950).

<sup>88</sup> See Pechman, note 22; Stanley Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (1973); see also Boris I. Bittker, Charles O. Galvin, R.A. Musgrave & Joseph A. Pechman, *A Comprehensive Income Tax Base? A Debate* (1977).

<sup>89</sup> The practicalities, although not the inherent desirability, of the fixation upon the comprehensive tax base are examined critically in Boris I. Bittker, *A Comprehensive Tax Base as a Goal of Income Tax Reform*, 80 *Harv. L. Rev.* 925 (1967); see also Stanley A. Koppelman, *Personal Deductions Under an Ideal Income Tax*, 43 *Tax L. Rev.* 679 (1988).

<sup>90</sup> In 1986 the most important story was the minimalist goal of interest groups in retaining previously won tax benefits in the face of the groundswell for tax reform. See Conlan et al., *Tax Reform*, note 3, at 4-9; Conlan et al., *Taxing Choices*, note 6, at 232 ("In tax reform, winners were those who retained some tax benefits instead of losing them altogether.").

cant to them is well known.<sup>91</sup> It is generally difficult to mobilize the "public" or any broad interest with regard to policies which have only marginal and dispersed effects, whereas narrow interests are easily mobilized and quite willing to act at great expense when issues most salient to them are at stake. The story of how the academic vision of tax reform triumphed, however briefly and incompletely, is much less familiar.

What most significantly distinguished tax reform in 1986 from the incremental policymaking which dominated during periods of politics as usual was the extraordinary origins and reformist ideology behind this legislation. Ironically, at the very moment that tax reform took as its goal the most abstract, ideological vision, it was supported by a strong and viable political coalition. This unusual convergence of theory and praxis resulted in an unpredicted political success which suggests that, contrary to the theorists of incrementalism, tax policy has come to be made at the national level through a complicated interplay of diverse forces, some tied to the politics of interest groups, but others quite clearly informed by the reformist's vision of the political order.

#### *B. Tax Reformism and the Attack Upon Tax Expenditures*

Tax reformism is hostile to any beneficial treatment provided to "special interests" via the Code. Perhaps the most common manifestations of such special treatment, although not always recognized in these terms, are the many domestic policies built into the Code in order to encourage particular social or economic activities, so-called tax "expenditures."<sup>92</sup> The use of tax expenditures to pursue a particular public policy allows Congress to avoid direct budget outlays while providing economic benefits or stimulants to the targeted beneficiaries of the programs.

The tax reformist's attack upon tax expenditures is based upon two premises. First, it is commonly asserted that the problem with policymaking through tax expenditures is that it shifts decisionmaking to that political arena most susceptible to domination by special interests—namely, the taxwriting committees. Second, to the reformist, the very use of tax expenditures to implement policies is objectionable because it contributes to the erosion of the revenue-raising capacity of the tax laws, negating the progressive rate structure. This is to say that tax expendi-

<sup>91</sup> The classic account of how special interest group politics influence the legislative process remains Surrey, note 59; see also Wilson, *Bureaucracy*, note 55, at 72-89.

<sup>92</sup> Tax expenditures are defined 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." The Congressional Budget and Impoundment Act, Pub. L. No. 93-344, § 3(a)(3), 88 Stat. 298, 299 (1974). For a comprehensive discussion of the dynamics of the political process of legislating tax expenditures, see Witte, *Politics*, note 18, at Chs. 14 and 15; Pechman, note 22, at 355-63; Stanley Surrey, *Tax Expenditures* (1985).



tures violate the principal of horizontal equity. Indeed, the congressional budgetary process which, however flawed, at least imposes some integrity upon the budget process, essentially is bypassed by the tax expenditure system. Budgetary constraints are circumvented when social and economic policies are made in the highly specialized tax committees where, it is argued, interest group politics is most intrusive and the influence of special interests is maximized.

In many respects the argument is misleading precisely because it links tax expenditures too closely to special interest politics. This ignores the fact that many tax expenditures are motivated by sincere efforts by representatives to implement some vision of the public good; it is quite possible that most tax expenditures at one time had their origin in honest attempts by public-minded representatives to implement social and economic policies in pursuit of the public interest as they perceive it, free of the pressures of interest group politics.<sup>93</sup> Even for those few "enlightened statesmen" (Madison's phrase<sup>94</sup>) who pursue public policy as a dispassionate search for the public interest, there is a strong temptation to so use the Code as a vehicle for implementing public policies.<sup>95</sup> This is

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<sup>93</sup> An example of such an attempt to use a tax expenditure to further the "public interest" was recently reported in *Senators, Industry Groups Seek Tax Breaks on Rebates, Transit Benefits*, Daily Tax Rep. (BNA) No. 116, at G-1 (June 17, 1991). Several senators have supported proposals to create tax incentives to encourage use of mass transportation and the purchase of energy efficient appliances. As Sen. Arlen Specter put it: "A little tax savings provides a great incentive." *Id.* However, as if to confirm the inclinations of those of a more cynical nature, the very same page of the Daily Tax Report outlines proposals for tax incentives intended to help "spur the real estate industry." *Rep. Pallone Calls for Tax Breaks to Jump-Start Real Estate Industry*, Daily Tax Rep. (BNA) No. 116, at G-1 (June 17, 1991). These proposals were announced by a New Jersey congressman at a recent press conference where he was "joined by representatives of the Board of Realtors . . . as well as representatives from the New Jersey Homebuilders Association." *Id.* These two examples illustrate the best and the worst of using tax expenditures to pursue public policy.

<sup>94</sup> *The Federalist*, No. 10, at 108 (James Madison) (John C. Hamilton ed., 1882) ("It is in vain to say that enlightened statesmen will be able to adjust these clashing interests, and render them all subservient to the public good.").

<sup>95</sup> Consider for instance a recent account of a single day's worth of lobbying for specific tax "expenditures," as reported in the BNA Daily Tax Report. The April 10, 1991 issue recounts the following items:

- (1) The House Select Committee on Children, Youth and Families announced that it will hold hearings on how to make the tax code "family friendly." This was taken to mean increasing the dependent exemption, increasing the standard deduction, reducing the marriage penalty, etc. *House Committee on Children Sets Hearing on How to Make Tax Code "Family Friendly,"* Daily Tax Rep. (BNA) No. 69, at K-1 (April 10, 1991).
- (2) President Bush reiterated his pledge to cut the tax rate for capital gains in order to "sweep away obstacles to free enterprise" and "unleash the power of the American imagination." *Bush Says Capital Gains Tax Inhibits the American Dream*, *id.* at G-2.
- (3) Representatives of a "broad spectrum of public and private groups," such as the Chamber of Commerce, urged the Ways and Means Committee to extend expiring tax provisions and lower the capital gains tax rate. The expiring provisions include the deduction for health insurance premiums paid by self-employed persons, R&D incentives, etc. *Private, Public Groups Urge Extensions of Expiring Tax Breaks*, *id.* at G-3.

attributable to the ability to legislate social and economic policy directly through tax expenditures, providing a convenient and attractive means of policymaking that allows politicians to circumvent the relatively more restrictive legislative process dominated by the budget and appropriations committees as well as the party leadership. In this way, and despite even the best of intentions, tax expenditures have become the social pork barrel of the tax committees. The politics of tax expenditures simply is played out in a different political arena than that of public legislation passed through the process of budget allocations.<sup>96</sup>

Policies enacted through the Code inevitably must be phrased in the rhetoric of the public interest, even those clearly supported by and catering to special interests. It has become commonplace rhetoric to assert that the public interest is best served by stimulating and encouraging various strategic economic sectors and industries.<sup>97</sup>

As public attention has been drawn to such obvious special interest provisions, tax expenditures have come to be viewed as "corrupting" the tax laws. Purportedly, this leads to undermining the "legitimacy" of the Code as well as diminishing the revenue-raising capacity of the federal income tax.<sup>98</sup> Indeed, the policymaking that emerges from pluralistic/incremental politics is now widely and cynically perceived by the public as little more than the inevitable triumph of vested economic interests.<sup>99</sup>

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(4) Senate Finance Committee members considered tax changes to help "reform" the health care system. Senate Panel Asks CBO for Politically Acceptable Health Care Reform Agenda, *id.* at G-6.

(5) A senator and congressman urged stepping up the push for legislation to increase the personal exemption because it is "fair" and "pro-family." Sen. Coats, Rep. Wolf to Step Up Efforts to Increase Amount of Personal Exemption, *id.* at G-8.

These proposals are offered as reforms, but all use the Code to provide tax incentives for specific public policies. The pressures in favor of such tax proposals are obviously significant.

<sup>96</sup> The classic study is Aaron Wildavsky, *The Politics of the Budgetary Process* (1964); see also Richard F. Fenno, *The Power of the Purse: Appropriations Politics in Congress* (1966).

<sup>97</sup> The most infamous example of pursuing special interest and privilege under the cloak of the public interest is the percentage depletion allowance, always justified in terms of developing and protecting domestic oil and gas production through the use of a tax incentive. But as much can be said for the public policy of aiding farming through the numerous special tax provisions providing favorable tax benefits for farmers and stimulating the real estate industry through all the many provisions of the Code enacted for no other discernable purpose than to promote the sale, development and ownership of (and hence, misallocation of resources in favor of) real estate.

<sup>98</sup> Such usage of the term "legitimacy" is inevitably overdramatic. Even the widespread publicity given in 1985 to reports of large corporations that failed to pay any corporate income tax, while "outraging" certain congressmen and senators, at least in their press releases, hardly can be said to have created a "crisis of legitimacy," to borrow a phrase. See James O. Freedman, *Crisis and Legitimacy: The Administrative Process and American Government* (1978).

<sup>99</sup> The reformists' attack upon hidden tax expenditures, instigated years ago by the late Stanley Surrey, has now drawn attention within political circles, but for very pragmatic reasons: "The idea of making clear the costs of tax loopholes by estimating the 'tax expenditure' associated with them was once an ivory tower notion. Now, with lobbyists for one expiring tax break fighting with lobbyists for others over a limited pool of funds allocated for tax incentives

The popular media encourages this view that economic interests located in the home state or district of a key congressman or senator on one of the taxwriting committees dictate policy outcomes.<sup>100</sup> In the public's as well as the tax reformist's mind, this kind of policymaking has come to personify politics as usual in the national political arena of tax policy.

Nevertheless, the 1986 success in attacking these very interests by eliminating their most sacred tax preferences and loopholes, makes it clear that interest groups are not the only, or even the dominant source of tax policy initiatives. It is plainly wrong-headed to look for a special interest lurking behind every tax expenditure and tax policy. The political arena now includes other players with a political agenda of their own.

Thus, the critique of tax expenditures must be based upon more than the premise that they represent special benefits for narrow interests. Instead, what is most significant is that the use of tax expenditures to implement social and economic policies makes for a bad policymaking process—one that has no direction, no budgetary responsibility and, accordingly, one that destroys the integrity of the Code. But locating the origins of the policy initiatives behind most tax expenditures is considerably more complicated than what is predicted by the interest group model.

### C. *Extraordinary Sources of Tax Reform*

A generation ago, judges made tax "law" from the bench as broad legislative standards were applied to individual cases. By the mid-1970's, the two most important sources of tax policymaking were political "entrepreneurs" (both those inside and outside formal governmental positions) and the tax "experts" who came to dominate the internal policymaking process through which the broad ideas behind tax policies are actually cast into public law. But "reform" as pursued by policy entrepreneurs and tax experts can be very different, with very different practical implications. Indeed, in many ways the impulses for reform that derive from these different sources are at odds. For instance, in re-

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under budget rules requiring revenue-neutral legislation, Harvard Law School Professor Stanley Surrey's theory has become the stuff of hardball politics." Rob Bennett, *From Ivory Towers to the Halls of Power*, 50 *Tax Notes* 1301, 1301 (Mar. 18, 1991).

<sup>100</sup> A 1990 comment by Senator Packwood of Oregon, ranking minority member of the Finance Committee, illustrates the reasons for this. In discussing the 1990 version of the proposal for a preferential rate for capital gains as compared with the 1989 version, Packwood considered the expansion of the provision to cover timber: "Frankly [last year's] proposal could not get out of the starting blocks for me because it excluded Oregon's major industries. I am pleased that the president's new proposal has fixed this problem . . ." Packwood *Introduces Bush Savings Bill; Urges Capital Gains Tax Cut for Business*, *Daily Tax Rep.* (BNA) No. 26, at G-1 (Feb. 7, 1990). Such honesty is refreshing in the political world.

cent years policy entrepreneurs<sup>101</sup> were the predominant impetus behind the movement for lower (and less progressive) marginal tax rates, as well as the more recent trend in favor of tax simplification. The latter is directly contrary to the tendency of tax experts to implement reform through a myriad of complex technical regulations that attempt to apply the new rule to all economic transactions and facts and circumstances.

By the 1980's, the sources of major initiatives in tax policy became much less obvious than in past decades. While the pressures exerted by the special interests on the tax committees remained significant, other sources rose to prominence as well, and to ignore them would be to miss the most interesting and important trends in recent tax policymaking. Since the 1970's, tax policy has been made through a dynamic process involving the interplay of both extraordinary sources of policy initiatives (such as the ideas of policy entrepreneurs and the technical reform proposals put forth by the tax experts) as well as the "politics as usual" of special interest groups, all played out within formal political institutions as well as non-institutional political space.

### *1. Tax Policy Entrepreneurs*

The political actors who first recognized the potential for successfully aggregating a broad coalition in favor of tax reform generally are acknowledged to have been Senator Bill Bradley, Representative Richard Gephardt and then Representative Jack Kemp (with President Reagan himself belatedly joining the chorus). These key political actors were neither beholden to special interests nor tied into the traditional politics that generally dominates the tax policymaking process. Rather, they were in many respects outsiders who realized the potential appeal and effectiveness of playing to reformist impulses and speaking in the reformist's rhetoric to mobilize political support for their own domestic policy agendas. In recent public policy analysis, such political elites are commonly referred to as "policy entrepreneurs."<sup>102</sup>

The policy entrepreneurs are said to adopt certain policies as their own in order to promote their own interests, gain favors and obligations for future bargaining or just because they personally favor those particular policies. For instance, Senator Bradley is recognized as one of those political elites most committed to tax reform in principle, and by force of conviction, was instrumental in bringing tax reform to the fore of the policy agenda. Representative Kemp also is viewed as a tax reform policy entrepreneur motivated by personal commitment to reform the tax

<sup>101</sup> See text accompanying note 102.

<sup>102</sup> See Daniel P. Moynihan, *Maximum Feasible Misunderstanding* 21-37 (1969); Nelson Polsby, *Political Innovation in America; The Politics of Policy Initiation* (1984); *Politics of Regulation*, note 57, at 371.

laws.<sup>103</sup> In this analysis, such eventual proponents of the 1986 Act as Daniel Rostenkowski, Robert Packwood, Richard Darman and even President Reagan himself, are viewed as political Johnny-come-latelies who jumped on the bandwagon merely out of fear of being left behind or, worse yet, being cast in the role of opponents of fairness, equity and reform.

Focusing upon the role of these policy entrepreneurs in instigating political momentum for tax reform is most useful in describing the sources of policy initiatives. On the other hand, those most familiar with the intense political maneuvering that ultimately was required to pass the 1986 Act generally have concluded that it was only the skillful guidance of Rostenkowski, and Packwood that made the passage of the Act a reality.<sup>104</sup> This is especially ironic to the extent that it implies that it was ultimately the "traditional" political institutions and actors (for example, the chairmen of Ways and Means and Finance Committees, and the leadership of the president) that mattered most.<sup>105</sup>

Of course, this should come as no real surprise given that the formal constitutional procedure for enacting legislation has not yet been repealed or abandoned: All bills still must pass both houses of Congress and confront executive approval or disapproval in some form or other. The new phenomenon of such great significance for tax policymaking is that the origin of recent tax reform proposals can be found as often in the halls of academia or the corridors of a think tank as on the agenda of a tax lobbyist.

Too much, however, can be made of the role of policy entrepreneurs in initiating policy and shaping the political agenda. (Congressmen have long used their power to introduce legislation that they know has no

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<sup>103</sup> See, e.g., Conlan et al., *Tax Reform*, note 64, at 27 ("Entrepreneurs like Kemp and Bradley seized upon professional concepts like horizontal equity and investment neutrality and converted them into powerful populist themes like fairness and economic growth."). The mere fact that tax reform could be applied in describing the policy agendas of two individuals holding such totally dissimilar ideologies in regard to such vital concepts as the role of government in shaping the economy and how taxation should be imposed upon business and individual taxpayers, merely serves to further highlight the emptiness of the concept of tax reform.

<sup>104</sup> Birnbaum & Murray, note 1, at 287 ("Dan Rostenkowski became a reformer because the president's endorsement of reform represented a challenge and a threat to both him and his party . . . Bob Packwood became a reformer out of desperation: With Reagan and Rostenkowski moving together, he had no choice but to produce a bill or be branded a sellout to special interests . . .").

<sup>105</sup> The importance of leadership in congressional politics, especially on the House Ways and Means Committee, lies not only in determining whether particular legislation, such as the 1986 Act, is enacted and in what form, but also in shaping broader institutional trends. For instance, the different leadership styles of Wilbur Mills, Al Ullman and Dan Rostenkowski are important factors in explaining the behavior of the Ways and Means Committee during the years of their respective chairmanships, as well as domestic tax policy itself. See, e.g., Strahan, note 33, at 101.



chance of passing to enhance their own position.<sup>106</sup>) Likewise, even if the ideas of Stanley Surrey or Joseph Pechman eventually became the policy initiatives of policy entrepreneurs, it must be recognized that those ideas had been circulating for a considerable period of time. This leaves the crucial question as why such ideas rose to the fore of the political agenda when they did and why policy entrepreneurs found these ideas attractive, both to themselves, personally, and to their constituencies.<sup>107</sup>

If Rostenkowski and Tip O'Neill ultimately came to accept and even embrace the notion of tax reform, most likely it was because they perceived that the political benefits to them, their party and the House (the political institution most dear to them) outweighed whatever countervailing pressures would be exerted by the lobbyists for those significant interest groups adversely affected by these proposals. This should be recognized as the beneficial outcome of an electoral politics in which political elites are subjected to the constraints of the electorate, and accordingly must weigh different interests and produce compromises capable of gaining enough support to make them work.

The traditional politics eventually reasserted itself and shaped the bill that actually emerged from conference committee (by protecting certain key interest groups, such as labor and oil and gas, from reform initiatives and by providing generous transition rules to very specific protected interests<sup>108</sup>). The initial proposals for tax reform were very clear statements of political values and ideology. For instance, Treasury I was the personification of the tax expert's vision of tax reform, ignoring all political practicalities, broadening the tax base and eliminating almost all special preferences.<sup>109</sup> Later, political considerations were felt, and the White House became more practical in its proposals, reflecting the Presi-

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<sup>106</sup> Perhaps the best example in the Senate is Jesse Helms. See Hedrick Smith, *The Power Game: How Washington Works* 60 (1988) ("[I]t did not matter to Helms's strategy that he was doomed to lose the Senate vote. He was playing to the grandstand—trying to fire up his reelection effort.").

<sup>107</sup> For instance, the recent attack upon tax expenditures has been motivated less by the sudden conversion to Stanley Surrey's views, than by economic considerations making such revenue losers unattractive in today's deficit conscious political climate. See Bennett, note 99. This has contributed in part to institutionalized changes in the tax committees. See, e.g., Strahan, note 33, at 136 ("Under Rostenkowski's leadership and the fiscal and political pressures created by massive budget deficits, by 1984 politics on the committee appeared in some respects to have come almost full circle since the [1974] reforms—back to the moderate partisanship, attention to fiscal responsibility, and consensual decisionmaking style of the Mills years.").

<sup>108</sup> For a discussion of the role of transition rules in furthering the passage of tax legislation in general, and the 1986 Act in particular, see Lawrence Zelenak, *Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?*, 44 *Tax L. Rev.* 563 (1989).

<sup>109</sup> U.S. Treasury Dep't, *Tax Reform for Fairness, Simplicity, and Economic Growth* (1984).

dent's own limited vision of reform—lower tax rates.<sup>110</sup> Thereafter, the traditional politics reappeared as Rostenkowski and Packwood each shaped his committee's respective version of tax reform legislation.<sup>111</sup> If the policy entrepreneurs set the process in motion, nonetheless, what was finally adopted as the 1986 Act was shaped by the executive branch and molded by the traditional players of partisan and interest group politics. The Act ultimately reflected input from both Houses of Congress, the executive branch and the tax experts from Treasury and the Joint Committee.

## 2. *Tax Policy Experts*

A former Commissioner of the Internal Revenue Service has warned the citizenry (undoubtedly somewhat with tongue in cheek) of the danger of experts making tax policy: "You don't want the tax-law pointy-heads running the world."<sup>112</sup> The impact of tax "experts" in making tax policy is often poorly understood in popular analysis of contemporary tax politics, although it dominates discussion in public policy analysis within the academic disciplines.

The staffs of the taxwriting committees in Congress (the House Ways and Means and the Senate Finance Committees as well as that of the Joint Committee on Taxation), represent one of the most significant institutional niches for the tax expert. These experts (tax lawyers and economists) have the difficult task of transforming vague congressional initiatives into tax policy. Beyond this, staff members themselves are the source of many legislative proposals. And even when merely implementing a congressional proposal, the staff does much more. First, the staff

<sup>110</sup> See President Reagan Unveils His Tax Reform Plan, 27 Tax Notes 1145 (June 3, 1985) (full text of President Reagan's May 28, 1985 speech announcing his comprehensive federal income tax reform proposals).

<sup>111</sup> Tax reformists sneer at the "corrupt" use of transition rules to benefit special interests located in the districts of committee members. However, the granting of favors by transition rules was one of Rostenkowski's most skillful tactics in gaining passage of a purer "reform" package than what would otherwise have been possible. See Conlan, et al., *Taxing Choices*, note 6, at 117-20 ("Thus, a great many provisions in the Ways and Means bill took care of the needs of supportive members and key constituencies . . . Many more won additional favors in the form of transition rules . . . Rostenkowski skillfully blended the old distributive politics of tax expenditures with the new politics of reform. By preserving tax provisions of greatest value to key members in the process of enacting reform legislation, the committee retained its all-important power to influence the tax code in beneficial ways."). *Id.* at 117-18. On the whole, aggregating support for a tax bill by offering generous transition rules (to permit certain industries or even individuals to retain more favorable tax treatment under prior law) should be viewed as preferable to offering new special tax provisions or expenditures that become a permanent fixture in the Code. The old maxim that politics is the art of the possible is lost upon those who seek the radical implementation of their ideal tax policies.

<sup>112</sup> *Wall St. J.*, Dec. 20, 1989, at A1 (quoting Fred T. Goldberg, Jr.). Whether Goldberg, a former tax lawyer in a large law firm, considers himself a "tax-law pointy-head" was left unstated.

actually drafts tax legislation. How a proposal is written as a bill often determines the breadth of its application, whom it affects and exempts and other equally significant factors. Thus, drafters exert considerable influence upon what ultimately emerges as public law.

Second, the legislative history of a tax bill often is written by committee staff members. Indeed, it is not unheard of for such legislative history to be created out of thin air by staff members.<sup>113</sup> Legislative history is extremely important in determining how courts and the Service interpret legislation, especially that which has no discernable purpose or intent. When Congress enunciates broad policies, federal courts are left to weigh congressional "intention," as divined in legislative history (sometimes inserted by a staff member precisely to establish authority for a particular view) in adjudicating individual cases and controversies.

Despite the importance of legislative history in determining how a tax bill is interpreted and applied, tax policy most often is shaped by the Service through its issuance of highly technical regulations as well as revenue rulings (and, to a lesser extent, the private letter rulings issued to individual taxpayers, which, although neither binding upon nor citable by other taxpayers, are followed by tax lawyers as indicative of the current thinking of the national office).

In the world of highly arcane and technical tax law, policies can be created, and not just implemented, through the regulations issued by Treasury. While a generation ago, it was judicial gloss upon the bare-bone statutes that added the real substance to the Code, tax laws now are given content by the tax experts at Treasury and the Service who issue the regulations and public authority which guides the actual practice of tax law. Courts seldom overturn the Service's interpretation of the Code, and even more rarely overturn a regulation as contrary to the intention of Congress, as expressed in the tax law or relevant legislative history.<sup>114</sup> Generally, the tax experts are granted extraordinary deference and leeway in administering the tax laws. This is contrary to a significant argument that such legislating through regulations is indicative of a failure of public policy.

Critics of the legislative process as it has emerged in the post-New Deal era have accused Congress of enacting what adds up to little more than broad pronouncements and leaving it to the experts to fill in the very content of the public policy. In his widely read and influential phi-

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<sup>113</sup> For a frank and critical admission by a former staff member regarding his own role in "creating" some legislative history in a Senate Finance Committee report, see James B. Lewis, *The Nature and Role of Tax Legislative History*, 68 *Taxes* 442, 445 (1990).

<sup>114</sup> Furthermore, some taxpayers must go to the very considerable expense of litigating the issue before the courts, a cost that adds strength to the Service's bargaining position.

lippic, *The End of Liberalism*,<sup>115</sup> first published in 1969, political scientist Theodore J. Lowi referred to the typical legislation enacted as little more than prophetic pronouncements by Congress (“Here is the problem—deal with it”), leaving it to the bureaucratic agencies to supply the goals, standards and means of achieving the stated vision.<sup>116</sup> A similar dynamic has arisen, albeit belatedly, in tax policymaking since the 1970’s. Congress often only expresses a broad vision, delegating the authority and responsibility to the experts at Treasury and the Service to implement the policy.<sup>117</sup> Of course, it should be no surprise that those tax experts drawn to public service in Washington are all too willing to seize such an opportunity to actually make federal tax policy. Where Congress hesitates to tread, tax experts are more than ready to jump in. Even where bound by the broad constraints of the statute as enacted by Congress, tax experts enjoy a considerable degree of autonomy in implementing their view of the ideal tax world, undoubtedly now more so than in other areas of public administration. What they enact through their “legislative” as well as “interpretive” regulations may turn out to be at odds with what is feasible and practicable to their brethren left behind in the more lucrative, but more mundane, world of private tax practice, to say nothing of the economic interests that are most adversely affected by their regulations. Interest groups, rather than dictating policy outcomes, often must turn to congressional committee members for relief from the regulations developed by tax experts.<sup>118</sup>

If the 1986 Act was qualitatively distinguishable from prior tax legislation, it was by the unusually significant input of the tax experts and the unpredicted success of the policy entrepreneurs in initially raising the whole issue of tax reform. However, it is misleading to suggest that the act was the culmination of “epiphenomenal” events or was a once-in-a-

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<sup>115</sup> Theodore J. Lowi, *The End of Liberalism: The Second Republic of the United States* 92-94, 303 (2d ed. 1979).

<sup>116</sup> Lowi wrote as a critic of the over-delegation of congressional authority to administrative agencies in the absence of any clear standards or principles. Hence, Lowi called for a return to heightened judicial scrutiny and exercise of the long dormant constitutional principle last evoked in *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). Most interestingly, while the Lowi perspective gained considerable influence in the 1970’s within the disciplines of political science and public policy, academics in the field of administrative law have held fast to the entirely contrary view, as best expressed in the highly influential treatise of Professor Kenneth Davis of the University of Chicago Law School. See Kenneth Davis, *Administrative Law Treatise* (2d ed. 1978); Kenneth Davis, *Discretionary Justice: A Preliminary Inquiry* (1977).

<sup>117</sup> Ironically, the trend may very well be in the other direction in other areas of public policy. For instance, Lowi wrote *The End of Liberalism* one year before the creation of the Environmental Protection Agency; the history of that agency suggests a different tendency than that imagined at the time. See Alfred Marcus, *Environmental Protection Agency, in Politics of Regulation*, note 57.

<sup>118</sup> An excellent defense of the post-New Deal regulatory state is Cass R. Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (1990).

lifetime success for reform. Its passage merely demonstrates the way in which major policy initiatives, especially tax policy, have their origins in sources other than interest group politics, even if those proposals are later molded during the legislative process by special interests. Perhaps the best way to state it is that tax experts and policy entrepreneurs are among those "special interests" most instrumental in raising policy initiatives, even while politics as usual remains a powerful force in shaping tax policymaking.

#### *D. Examples of the New Dynamics*

##### *1. Tax Shelters*

A dramatic example of the dynamic process whereby Congress pontificates and tax experts legislate is the broad mandate of the 1986 Act to outlaw tax shelters. A tax shelter is really nothing more than a particular investment vehicle that first arose in the 1960's and rapidly became a popular vehicle for reducing current tax liabilities.<sup>119</sup> A shelter is most attractive to investors to the extent that it can create "artificial" tax losses (usually generated by accelerated depreciation allowed by the various incarnations of the investment tax credit, as well as special tax accounting rules, in particular rules for claiming tax depreciation) which have no "economic reality." This is taken to mean that the taxpayer will never really suffer an economic loss corresponding to the tax deductions claimed. Tax losses, including those without corresponding economic losses, are passed through to investors (most often, limited partners in limited partnerships) who use them to offset income derived from other sources, sometimes wages, but more often the self-earned income of lawyers, doctors, dentists and others in the envious position of having significant income in need of "shelter."

Widely portrayed by the media and perceived by the public as inherently abusive,<sup>120</sup> prior reform efforts to regulate the tax shelter had failed to pass the gauntlet of special interests poised to oppose any such attack upon their most significant bread and butter issue. This failure generally

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<sup>119</sup> In October 1983, the Commissioner announced that the Service was undertaking a program to eliminate "abusive" tax shelters. At the time, there were more than 325,000 shelters under examination by the Service and more than 17,000 shelter cases docketed in the Tax Court. See Philip E. Coates, IRS "Front-End" Attack on Abusive Shelters 1 (Nov. 19, 1984) (unpublished manuscript prepared for the New York University Institute on Federal Taxation, Second Annual Conference on Tax Shelters).

<sup>120</sup> See Colin Campbell, Art Donors Facing Stricter Tax Rules, N.Y. Times, July 2, 1984, at C11; Robert D. Hershey, Pursuing Cheaters and Bogus Shelters, N.Y. Times, Sept. 19, 1984, at A24; Gary Klott, Investing For After-Tax Returns; Tax Shelters Under Fire, N.Y. Times, Mar. 2, 1986, at 12:26; Jay Korn, Personal Finance; Steering Clear of Abusive Tax Shelters, N.Y. Times, July 7, 1985, at 3:9; We Got Rid of Tax Shelters; Don't Revive Them Now, Newsday, Oct. 4, 1990, at 80.



was attributable to the inability of reformists in Congress to define the perceived abuse in such a way as to allow it to be practicably regulated (and hence eliminated) without also simultaneously subjecting common and accepted economic and business arrangements to the same restrictions.

The tax shelter offended nearly all of the dominant principles of tax reform in the mid-1980's. In an era in which fewer and fewer sources of income were left to bring into the income tax base as a result of the very success of tax reform, the tax shelter offered a ready target.

The preferential rate for capital gain<sup>121</sup> was also an important aspect of tax shelters (as well as other numerous and ingenious arrangements) which converted ordinary income into capital gain obtaining the benefit of the lower tax rate as well as deferral of the gain itself until recognition. Indeed, numerous Code provisions were enacted solely to prevent (perhaps in vain) the conversion of ordinary income into capital gain.<sup>122</sup>

Tax policies designed to encourage capital investment (for instance, by allowing accelerated depreciation and the ITC) were legally available to tax shelters as well as any other "legitimate" taxpayer. Indeed, this was the purpose of these provisions: to direct capital into favored uses through tax incentives. The tax laws, however, are simply incapable of being sufficiently finetuned so as to discriminate in favor of those kinds of economic activity that are desired and against those that are not. A tax shelter is the legitimate offspring of tax laws designed to promote economic policy through certain tax incentives. The flaw lies in using the Code to pursue such policy goals, not in the "illegal" promotion of tax shelters.

Prior to 1986, Congress had attempted to regulate tax shelters through several methods. For instance, the "at-risk" rules<sup>123</sup> are intended to limit the tax deductions available to an investor in a tax shelter to the funds actually invested in the venture.<sup>124</sup> This prevents an investor from

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<sup>121</sup> Section 1202 excludes 60% of capital gain recognized on the sale of long-term capital assets, former IRC § 1202—capital assets acquired and held for at least one year, IRC § 1222(3), (4)—thereby reducing the effective maximum marginal tax rate for capital gains to 20% under pre-1986 tax rates.

<sup>122</sup> For instance, the recapture rules of §§ 1245 and 1250 were enacted pursuant to the Revenue Act of 1962, Pub. L. No. 87-834, § 13, 76 Stat. 1032, and the Revenue Act of 1964, Pub. L. No. 88-272, § 231, 78 Stat. 100, respectively, in an effort to prevent the conversion of ordinary income into capital gain by the use of tax depreciation. These sections were retained in 1986 even though tax rates for capital gain and ordinary income were equalized, ostensibly because there were other advantages for characterizing income as capital gain and because it was widely recognized that it was only a matter of time before there would be pressure, and perhaps success, in resecuring a preferred rate for capital gain. Bluebook, note 76, at 179.

<sup>123</sup> Pub. L. No. 94-455, § 204, 90 Stat. 1531 (1976) (codified as § 465).

<sup>124</sup> For a comprehensive discussion of the at-risk rules as a means of curbing the perceived problems of tax shelters, see Stanley A. Koppelman, *At-Risk and Passive Activity Limitations: Can Complexity be Reduced?*, 45 *Tax L. Rev.* 97 (1989).

purchasing tax losses in excess of his actual investment, or the amount at risk. The at-risk rules, however, contained an exception for real estate investment.<sup>125</sup> Although modified substantially in 1986, the at-risk rules still exempt qualified nonrecourse debt<sup>126</sup> which is typically used in financing real estate development projects. The justification for this exception was that the real estate market would be particularly hard hit by an extension of the at-risk rules to nonrecourse debt financing because it is so prevalent in that sector.<sup>127</sup> Such reasoning hardly justifies the preferential treatment since the use of nonrecourse financing by tax shelters was the most prevalent manifestation of the very abuse Congress was attempting to curb. To the contrary, Congress simply was unable to pass legislation which would have impacted so adversely upon the tax shelter industry as it related to real estate investment. Interest group pressures are effective in the absence of any significant countervailing power, such as a strong tax reformist movement.

Additional legislation was passed to curtail the perceived abuse of shifting allocations of the tax deductions generated by a business enterprise (be it a tax shelter or not) among partners in a partnership in a manner so as to reduce the total tax liability of the partners.<sup>128</sup> However, unlike the at-risk rules, this was largely implemented through so-called legislative regulations which provide intricate details to the bare-bones statutory standard imposed upon partnership allocations of tax losses.<sup>129</sup> This "reform" was mandated by Congress, but actually was implemented by tax experts in Treasury and the Service through the issuance of regulations. It represents one of the clearest examples of how a vague delegation of authority by Congress without standards or guidelines results in greater complexity.

This approach, however, was deemed inadequate to curb tax shelters, and as part of the bargain of the 1986 Act, the passive activity loss (PAL) rules were introduced by Congress to attack tax shelters.<sup>130</sup> The basic idea behind this "reform" was to prevent taxpayers from using losses generated from "passive" activities (that is, tax deductions from tax shelters and other passive investments) to offset income derived from either

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<sup>125</sup> The Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, extended the at-risk rules to all activities except real estate and certain equipment leasing engaged in by closely held corporations.

<sup>126</sup> IRC § 465(b)(6).

<sup>127</sup> See Bluebook, note 76, at 257-60.

<sup>128</sup> Pub. L. No. 94-455, § 213(d), 90 Stat. 1520 (1976) (codified as § 704(b)).

<sup>129</sup> Reg. § 1.704-1(b)(1)-(5); Temp. Reg. § 1.704-1T(b)(1)-(5). The statute itself merely provides that tax allocations among partners must have "substantial economic effect." IRC § 704(b). The meaning of this phrase as defined in these regulations can be discerned only through long experience in the specialized field of partnership tax law, if even then.

<sup>130</sup> IRC § 469.

portfolio investments (dividends or interest income) or earned income (wages or self-earned income). This approach appears relatively simple.

The problem, once again, was that the vague and overly broad language introduced into the Code in the burst of tax reformism was entirely useless in enforcing rules against the careful planning of tax lawyers looking to avoid their application. Thus, it again fell to the tax experts at Treasury and the Service to provide through regulation that which was otherwise unattainable through statute. The resulting passive activity loss regulations<sup>131</sup> are comprehensive and complicated (which means incomprehensible to taxpayers, the judges who actually adjudicate disputes over the interpretation of the federal statute and even many tax lawyers who deal with them on a frequent basis).

Introduced to date in three sets of temporary and proposed regulations, the passive activity loss regulations already amount to almost 180 pages that must be navigated by any taxpayer involved in multiple investment activities. Indeed, the regulations require some 40 pages just to define what is meant by an "activity," a vital enterprise when it is remembered that the rules generally require a taxpayer to separately account for each separate activity. The increased complexity has even tempered the enthusiasm of those who initially saw the passive activity loss rules as the vehicle to tax fairness.<sup>132</sup> Fortunately, the majority of taxpayers will never need to confront these technical rules because they do not invest in businesses in which they do not actively participate. However, for those who do, they must confront some of the most impenetrable and convoluted regulations.<sup>133</sup> These are the kind of needlessly complex regulations that ultimately lead taxpayers to ignore the statute altogether and declare in exhaustion: "I'll worry about it when the IRS audits me." Yet, as every tax practitioner knows, that is precisely when it is too late to comply. On the other hand, with the passive activity loss rules and the substantial economic effect rules for partnerships, this may be the only sensible, economical and rational path for many taxpayers. While we do not often wish to admit it, tax practitioners are now com-

<sup>131</sup> Temp. Reg. § 1.469-0T.

<sup>132</sup> See, e.g., Stephen P. Allen, Fixing The Passive Activity Loss Rules, 50 Tax Notes 1419 (Mar. 25, 1991) ("The PAL rules have been quite effective in dealing with tax shelters. Unfortunately, they have also produced a serious side effect: a substantial increase in tax law complexity. In making the tax system more fair, Congress has also made it more incomprehensible.").

<sup>133</sup> As one commentator has put it: "It is now three years after the enactment of the limitation on passive losses. And something is terribly wrong. From a simple idea to limit tax shelters there has developed a set of statutory rules and administrative regulations of immense complexity. The complexity of these rules is so great that most taxpayers will *never* be able to understand them." Richard M. Lipton, PALs at Three: What We Know, What We Don't Know And What Went Wrong, 67 Taxes 715, 715 (1989); see also Richard M. Lipton, PALS at Four: Living with the Regulations, 68 Taxes 779 (1990).

monly confronting smaller partnerships that in all good faith have given up struggling with these rules and have chosen simply to make a reasonable effort to comply and thereafter throw their fate to the "audit lottery."<sup>134</sup> Likewise, small businesses and small corporations find that the increased complexity of the tax laws has made compliance in certain areas difficult, if not impossible.<sup>135</sup>

In fairness to the tax experts who drafted these regulations, it was Congress that forced their hand by passing legislation which, while expressing an enthusiasm for tax reform, lacked any coherent vision of how that reform would be expressed in cognizable rules by which citizens are able to plan their behavior in order to comply. The result is tax "laws," such as the passive activity loss rules, that defy the very notion of "rule by law." These are not laws in the traditional sense that the citizenry can take notice of, and accordingly plan their actions. Quite the contrary, it is unclear what activity or behavior is forbidden (i.e., which deductions are suspended or which allocations have "substantial economic effect") and what is sanctioned (i.e., deductible)—the very essence of the rule of law. In many ways, it appears as if the ideal of the rule of law, a principal central to our liberal political culture, has been largely abandoned in the realm of tax law.

## 2. *Capital Gains: Tax Reform or Loophole?*

One of the most curious examples of how politics as usual and reformist impulses have become intertwined in the development of the tax laws is found in the recent posturing and lobbying (both in favor of and against) the reinstatement of a preferential rate for the taxation of capital gain. When the Bush administration first raised serious proposals for the reinstatement of a preferential tax rate,<sup>136</sup> the Democratic leadership of both the House and the Senate immediately responded with protests of foul play.<sup>137</sup> The opposition to this proposal steadfastly has maintained that a preferential tax rate for capital gains favors the rich at the expense

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<sup>134</sup> This may be rational, although contrary to law. See Rita Zeidner, *Audit Rate Drops Again, Annual Report Discloses*, 53 *Tax Notes* 515, 515 (Nov. 4, 1991) (reporting that the IRS audit rate in 1990 was .8% for individual returns and 2.59% for corporate returns).

<sup>135</sup> "We believe that most noncompliance is unintentional. Much of it is due to the complexity of the tax laws." *Wall St. J.*, June 27, 1991, at B2 (remarks of then Commissioner Fred T. Goldberg, Jr.).

<sup>136</sup> See Sean Ford, *Bush Budget Kind and Gentle to Capital Gains and Savings; Brady Denies He's on Way Out*, 46 *Tax Notes* 605 (Feb. 5, 1990); Ian K. Loudon, *No Tax Surprises in '91 Budget As Bush Seeks Capital Gains Cut, Family Savings Initiative*, 46 *Tax Notes* 607 (Feb. 5, 1990).

<sup>137</sup> See Pat Jones & Lane Davenport, *Bush Tax Proposals Roughed Up Before House, Senate Tax Panels*, 46 *Tax Notes* 1223 (Mar. 12, 1990).

of the middle class and the poor.<sup>138</sup> During the Fall 1990 negotiations over the various components of the budget reconciliation revenue package under consideration, the Democratic leadership of Congress seemingly committed itself to the position that any deviation from current tax policy should be judged based upon the criteria of whether it sufficiently "soaks" (or at least seriously wets) the rich.<sup>139</sup> In more serious criticism, congressional Democrats have argued that any return to a lower rate of taxation for capital gain would breach the implicit bipartisan bargain that was central to the passage of the 1986 Act.<sup>140</sup> As such, it would lead to the unravelling of the whole reformist package as every other special interest would be back at the tax committees' doorstep to plead its own case. Furthermore, pursuant to the academic vision of tax reform which became dominant in the 1980's, the tax benefit derived from the lower rate imposed on long-term capital gain was perceived as an unjustifiable special tax break. Even worse, it was perceived to violate the principal of horizontal equity to the extent that it was available only to "wealthy" taxpayers, although economists are entirely mixed as to the impact of the preferential rate on the population of taxpayers as a whole.<sup>141</sup>

The preferential treatment for capital gain had been given up as one of the many political concessions necessary to pull together the broad coalition which eliminated or limited many of the most unjustifiable tax loopholes. The preferential rate was abandoned as part of the same legislative package and in the same reformist spirit. What is so ironic about the current campaign led by the Bush administration for a return to special treatment of capital gain is the extent to which proponents, as well as opponents of this proposal, have made such generous use of the rhetoric of tax reform. It is almost as if any major tax legislative proposal put forth now must be cloaked in the rhetoric of tax reformism in order to be taken seriously in the post-1986 world. But use of such rhetoric does not in itself make for tax reform, not even by the standards of the 1986 Act.

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<sup>138</sup> See Pat Jones, *Depreciable Asset Exclusion Complicates Debate on Bush Capital Gains Plan*, 42 Tax Notes 1288, 1288 (Mar. 13, 1989) [hereinafter *Asset Exclusion*]; Pat Jones, *Taxwriters Look at Capital Gains*; Brady Nixes *Rate Trade*, 42 Tax Notes 1407, 1407 (Mar. 20, 1989); Richard L. Schmalbeck, *The Uneasy Case For a Lower Capital Gains Tax: Why Not the Second Best?*, 48 Tax Notes 195, 201-02 (July 9, 1990).

<sup>139</sup> William Safire traces the first written citation of the slogan "soak the rich" to James P. Warburg's 1935 book, *Hell Bent for Election*, in which he charged Franklin D. Roosevelt with trying to steal the thunder from Huey Long by coming out with his own "soak the rich" message. Apparently, the phrase was used previously in a speech on the House floor by then Congressman Fiorello La Guardia. See William Safire, *On Language*, N.Y. Times, Nov. 11, 1990 (Magazine), at 22; Dec. 9, 1990 (Magazine), at 26.

<sup>140</sup> See Jones, *Asset Exclusion*, note 138, at 1288.

<sup>141</sup> See Schmalbeck, note 138, at 195; Staff of the Congressional Budget Office, *Capital Gains and Economic Growth*, 49 Tax Notes 105 (Oct. 1, 1990); Congressional Budget Office, *Indexing Capital Gains*, 49 Tax Notes 103 (Oct. 1, 1990).



The case for a preferential rate has been stated broadly in terms of the need to amend the tax laws in order to implement specific national economic policies, namely, to encourage the formation of capital and encourage liquidity in the capital markets.<sup>142</sup> Accordingly, the preferential rate has been held out as a reform capable of stimulating a slumping economy (presumably, starved by the misallocation of capital locked into existing investment assets as a result of excessively high tax rates imposed upon sales triggering a taxable gain).<sup>143</sup> Alternatively, the preferential rate for capital gains has been justified in terms of the additional revenues that it would raise (purportedly to be derived from the increased volume in capital transactions in which gain is recognized), thereby echoing the supply-sider's theme that lower tax rates actually increase revenues by increasing economic incentives.<sup>144</sup> Indeed, even at the risk of sacrificing success on broader political issues, such as reaching a meaningful bipartisan agreement on budget deficit reduction, President Bush consistently has adhered to a capital gains tax cut almost as an article of religious faith based upon these twin principles of raising revenue and stimulating the economy.<sup>145</sup> Conversely, key Democrats in Congress, especially those on the highly visible taxwriting committees, consistently, and just as religiously, have denied both assumptions. What is hailed on one side of the partisan fence as tax reform is denounced on

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<sup>142</sup> It should come as no surprise that many of those who favor the use of a preferential tax rate for capital gain in order to stimulate investment (i.e., a tax expenditure), are opposed to the use of tax expenditures for other purposes. For instance, Deputy Assistant Secretary for Tax Policy, Michael Graetz, expressed the Bush Administration's opposition to the use of tax expenditures to stimulate the use of mass transportation because such would be an "inefficient" policy tool. Pallone Article, note 93, at G-1. Presumably, stimulating the economy as a whole requires less efficiency in policymaking.

<sup>143</sup> Others argue that it is necessary that investors in stock (i.e., shareholders) be encouraged to adopt a long-term perspective, rather than look for short-term gains. However, whether a preferential rate for long-term capital gain encourages such a perspective, and whether that is actually desirable, is open to debate. See, e.g., James R. Repetli, Long-Term Capital Gains, the Long-Term Investment Perspective, and Corporate Productivity, 42 Tax Notes 85 (Oct. 1, 1990).

<sup>144</sup> The original proponent of this aspect of the supply-side theory was Arthur B. Laffer, a member of President Reagan's Economic Policy Advisory Board. See Victor A. Canto, Douglas H. Joines & Arthur B. Laffer, *Foundations of Supply-Side Economics* (1985); Victor A. Canto & Arthur B. Laffer, *Supply-Side Portfolio Strategies* (1988). An articulate and compelling statement is Lawrence B. Lindsey, *The Growth Experiment: How Tax Policy is Transforming the U.S. Economy* (1990); a more passionate, but less sophisticated account is Jude Wanniski, *The Way The World Works* (1978).

<sup>145</sup> Capital Gains Tax Cut Would Lower Cost of S&L Bailout, U.S. Chamber Report Says, Daily Tax Rep. (BNA) No. 181, at G-7 (Sept. 18, 1990); David Wessell & Jackie Calmes, Bush Still Seeks Capital-Gains Tax Cut As Negotiators Haggle Over Trade-Off, Wall St. J., Sept. 18, 1990, at A32, col. 1. The issue was finally put on hold as the proposal for a preferential rate was dropped as of mid-October 1990 pursuant to the failed attempt by Senate Republicans to have it included in the budget reconciliation bill ultimately adopted by the Conference Committee. No doubt it can be expected to resurface again in future negotiations concerning budget deficit reduction.

the other as its very betrayal. This has obscured the fact (obvious to anyone with even the slightest cynical streak) that the debate is really one of political principles, not tax reform.

Pressures for a reduction in the capital gain rate began to be exerted almost as soon as the tax rates for ordinary income and capital gain were equalized in 1986. (This much would be entirely predictable by the theory of incrementalism given the pluralistic structure of politics and the resiliency of interest group pressures.) Beginning in 1981, the differential between the rate of tax imposed on long-term capital gain as compared to that on ordinary income had increased markedly as the former was reduced to a post-World War II low of 20% while the latter was reduced to 50% from the historic high of 70%.<sup>146</sup> As a result, the relative difference between the two rates for the period between 1981 and 1986 was as much as 30% for taxpayers in the highest marginal tax bracket. This difference, an historic high, emerged as a significant driving force behind the growth of the tax shelter industry. The imbalance between the two rates was resolved eventually by the 1986 Act. Nevertheless, the mere equalization of the two rates took considerable steam out of the tax shelter industry to the extent that it was, at least in part, based upon the ability to convert ordinary income into capital gain. As would be expected, efforts to reinstate a differential rate have been supported by the tax shelter industry which recognizes the unlimited marketing possibilities in a revival of any form of the tax shelter.

Curiously enough, since the commencement of the Bush administration's pursuit of a return to a preferential rate, the Democratic opposition has largely ignored the linkage between the preferential rate and the tax shelter industry. It has failed to raise the serious structural and functional problems associated with a differential rate.<sup>147</sup> Little has been said of the havoc that a differential between the two rates creates for the administration of the Code. Instead, the response has been to offer as an alternative the equally implausible and economically unproven path of stimulating investment through special tax-deferred savings plans, specif-

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<sup>146</sup> Economic Recovery Tax Act of 1981 Pub. L. No. 97-34, § 102, 95 Stat. 186 (setting a maximum rate of 20% on qualified net capital gain); IRC § 1 (before amendment in 1986) (setting a maximum rate of 50% on ordinary income).

<sup>147</sup> The Committee on Taxation of the Association of the Bar of the City of New York issued a report in 1989 which concluded that the elimination of the capital gain preference in 1986 resulted in significant simplification of transactions. Letter to Lloyd Bentsen from Committee on Taxation of the Association of the Bar of the City of New York, LEXIS, Fed. Tax Library, TNT (Sept. 28, 1990). Surprisingly, the Democratic opposition to President Bush's proposals have ignored this argument. Conversely, conservatives who otherwise would favor simplification of the taxation of economic transactions find it convenient to ignore this issue as they plead their case for special tax treatment of capital gain.

ically, an expanded version of the IRA.<sup>148</sup> To a cynical observer, this could be construed as a blatant political appeal to the constituency of the Democratic party, masquerading as economic policy.<sup>149</sup> Likewise, the response to shift the tax burden to the rich through the phase-out of personal exemptions and limitations on itemized deductions as well as higher-marginal tax rates<sup>150</sup> clearly expresses a class-based populist politics cloaked in the rhetoric of tax reform. (This was especially true in regard to the proposed 10% surcharge on taxable income exceeding \$1 million, initially introduced by House Democrats as part of the October 1990 budget reduction negotiations,<sup>151</sup> later abandoned in favor of the higher marginal rate and limits upon personal exemptions and itemized deductions, but boding ominously on the horizon for the future when the fairness issue inevitably is resurrected.<sup>152</sup>)

Whatever the economic and political merits of these and a host of other related proposals, recent legislative efforts all too often have been marked and characterized by hasty and ill-conceived attempts to incorporate very complicated and technical economic policies into political proposals couched in and buttressed by the rhetoric of tax reform. Unfortunately, the policies underlying these purported "reforms" tend to inflict even further strains upon the tax laws as political expediences rather than thoughtful economic policies drive the legislative process.

## 2. *Tax Reform for the 1990's: Simplification*

One of the perennial themes of tax reformists has been the simplification of the tax laws.<sup>153</sup> Indeed, even the Revenue Act of 1913 which implemented the present federal income tax in what now appears to be a

<sup>148</sup> The so-called "super IRA" proposal was introduced in early 1991 by Senate Finance Committee member William Roth and Committee Chairman Lloyd Bentsen. Different versions of the bill have been put forth over the last year. See, e.g., S. 612, 102d Congress, 1st Sess. (1991).

<sup>149</sup> It also should be noted that proposed "back-loaded" IRAs (e.g., IRAs in which deposits are made in after-tax dollars, with interest accumulating free of tax) present considerable political difficulties in a world of revenue-neutral tax legislation since they are by definition revenue-losing proposals.

<sup>150</sup> IRC §§ 1, 68, 151(d) (as amended by the Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, §§ 1101, 1103-1104, 104 Stat. 1388-400, -403 to -408).

<sup>151</sup> This surtax was part of the House bill, but was excluded from the Conference Agreement which ultimately was passed as the Revenue Reconciliation Act of 1990. See H.R. 5835, 101st Cong., 2d Sess. (1990); H.R. Rep. No. 964, 101st Cong., 2d Sess. 1033 (Conf. Rep.) reprinted in 1990-3 C.B. (vol. 2) 1033.

<sup>152</sup> Ronald Pearlman, former Chief of Staff of the Joint Committee on Taxation, predicted that the debate of "rich versus poor" would continue during the next congressional session. *Daily Tax Rep. (BNA) No. 232*, at G-4 (Dec. 3, 1990).

<sup>153</sup> Sidney I. Roberts, Wilbur H. Friedman, Martin D. Ginsburg, Carter T. Louthan, Donald C. Lubick, Milton Young & George E. Zeitlin, *A Report on Complexity and the Income Tax*, 27 *Tax L. Rev.* 325 (1972); Brockway, note 71, at 1803 ("True tax reform will not be achieved unless there is significant simplification of code provisions.").

rather uncomplicated form, was initially perceived as far too complicated to be understood even by rather sophisticated taxpayers.<sup>154</sup> If the first tax laws struck contemporaries as complex, successive years of use and refinement should have brought some degree of certainty to taxpayers and practitioners. Yet, even as the 1939 Code was administratively manageable by today's standards, it was problematic from the perspective of contemporary reformists who saw the many sources of potentially taxable revenue escaping the grasp of the fisc.

With the expansion of the post-New Deal administrative state during the years following the enactment of the 1939 Code, the need for government revenue greatly increased. Furthermore, the wartime needs of the federal government also stimulated the search for greater revenue.<sup>155</sup> The rise of the tax administrative state was necessitated by the need to administer the ever expanding income tax as well as the need to confront the increasingly sophisticated world of business, corporate finance and tax lawyers. The Code grew in complexity as lawmakers sought new sources of revenue and implemented new statutes merely to control the perceived "abuse" of the tax laws (that is, structuring business transactions so as to minimize or avoid entirely the application of the tax laws). At the same time, in the post-World War II decades, the success of tax experts in drafting new all-encompassing regulations contributed to the spectacular growth of the Code as it attained awesome complexity.<sup>156</sup>

As the regulations interpreting the Code and implementing the intentions of Congress became increasingly more complicated in the 1970's, thereafter virtually exploding in the 1980's, the pressures for simplification have heightened. Some reform efforts have been directed at specific Code provisions and regulations, such as the infamous § 89 regulations applying cumbersome and incomprehensible nondiscrimination rules on tax-favored retirement plans.<sup>157</sup> These regulations ultimately were withdrawn due to the significant public outcry and resulting political pres-

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<sup>154</sup> Senator Elihu Root of New York in 1913 wrote to a friend who had complained about the complexity of the Revenue Act of 1913: "I guess you will have to go to jail. If that is the result of not understanding the Income Tax Law I shall meet you there. . . . [F]or no one understands the Income Tax Law except persons who have not sufficient intelligence to understand the questions that arise under it." Harold Dubroff, *The United States Tax Court: An Historical Analysis* 12 (1979).

<sup>155</sup> Witte, *Politics*, note 18, at 128-30.

<sup>156</sup> For a discussion of the forces pushing toward greater complexity, see generally, Joint Comm. on Tax'n, 95th Cong., 1st Sess., *Issues in Simplification of the Income Tax Laws*, (Comm. Print 1977); Boris I. Bittker, *Tax Reform and Tax Simplification*, 29 *U. Miami L. Rev.* 1 (1974); James S. Eustice, *Tax Complexity and the Tax Practitioner*, 45 *Tax L. Rev.* 7 (1989); Paul McDaniel, *Federal Income Tax Simplification: The Political Process*, 34 *Tax L. Rev.* 27 (1978); Sidney I. Roberts, *Simplification Symposium*, 34 *Tax L. Rev.* 5 (1978); Stanley Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 *Law & Contemp. Probs.* 673 (1969).

<sup>157</sup> IRC § 89 (before amendment in 1989).

tures.<sup>158</sup> Other proposals are broad pleas for tax simplification that play well in Washington and among constituents.<sup>159</sup> Former Commissioner Goldberg has become a proponent of simplification.<sup>160</sup> In addition, Senator Bentsen and Representative Rostenkowski have picked up the theme and introduced a package of simplification proposals.<sup>161</sup>

Little of the current reformist posturing for simplification of the tax laws acknowledges the inherent inconsistencies in the position. The great complexities of the tax laws are precisely the result of the implementation of yesterday's reforms that sought ever greater purity in the application of the tax laws. For example, the passive activity loss rules were aimed at eliminating tax shelters, the original issue discount (OID) rules were aimed at preventing tax avoidance through deferral of the payment of tax and the § 89 proposed regulations sought to prevent discrimination in the use of pension plans and other tax-favored benefits by management to the exclusion of other workers. These and other changes were originally conceived of as reforms, implemented in the past decade to prevent abuses of the tax laws. They ended up increasing the complexity of the tax laws to the point of where they nearly become dysfunctional—that point when taxpayers and the Service can no longer understand or apply the tax laws, thereby potentially resulting in less revenue being raised.<sup>162</sup>

In any event, to pursue tax simplification as a goal in itself, ignoring the reasons for complexity in the tax laws, makes no sense except as political rhetoric. Of course, to the extent that the computation of tax liabilities, filling out forms and the multitude of filing requirements can be simplified for a majority of individual taxpayers, as it was by the 1986 Act,<sup>163</sup> even while businesses and wealthy taxpayers confront increased

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<sup>158</sup> Pub. L. No. 101-140, § 203 (1989) repealed IRC § 89. See also Elin Rosenthal, Section 89 Foes Unimpressed by Treasury's Attempts at Compassion, 42 Tax Notes 528 (Jan. 30, 1989); Elin Rosenthal, Sobering Thoughts Intrude on Eulogy of Section 89, 45 Tax Notes 930 (Nov. 20, 1989).

<sup>159</sup> See, e.g., *Federal Income Tax Simplification* (Charles H. Gustafson ed., 1979); Deborah H. Schenk, *Simplification for Individual Taxpayers: Problems and Proposals*, 45 Tax L. Rev. 121 (1989).

<sup>160</sup> See Lane Davenport, Marianne Evans & Sean Ford, *Goldberg Still Beating Drum For Simplification; Says IRS Budget is Way Out of Balance*, 45 Tax Notes 1398 (Dec. 18, 1989).

<sup>161</sup> Tax Simplification Act of 1991, S. 1394, H.R. 2777, 102d Cong., 1st Sess. (1991).

<sup>162</sup> The converse (and generally unconvincing) argument is that increased complexity results in increased uncertainty, which enhances the litigation posture of the Service and the fees of tax lawyers representing their clients in disputes. See Michelle J. White, *Why Are Taxes So Complex and Who Benefits?*, 47 Tax Notes 341 (Apr. 16, 1990). This argument reduces all actors in the political process either to income maximizers or self-aggrandizing bureaucrats, and thus totally ignores the role of ideas and principles in motivating those who formulate tax policy and draft legislation, a perspective typical of an economist.

<sup>163</sup> See Bluebook, note 76, at 11 (stating that "[S]implification of the tax code itself is a form of tax reduction. . . . The Act reduces the complexity of the tax code for many Americans. . . . Taxpayers who will use the standard deduction rather than itemize their deductions will be



complexity, political expediencies very well may be sufficiently satisfied. Absent the articulation of any reasoned analysis of what is to be gained (as well as the recognition of what is lost) by pursuing simplification of the tax laws as a goal in itself, this rhetoric of tax reformism is without coherence or consistency.

It is true that tax simplification and the attack upon tax expenditures go hand-in-hand to achieve a comprehensive tax base by eliminating the many tax deductions made available to taxpayers by tax pork barrel politics. But it must be recognized that this has very little to do with the real source of the complexity of the Code: the statutes, regulations and administrative policies aimed at curbing tax avoidance.<sup>164</sup> It is entirely disingenuous to cast the issue of tax simplification in terms of simplifying the preparation of tax returns by eliminating tax deductions or imposing threshold requirements (for instance, as a percentage of adjusted gross income) which most taxpayers will be unable to satisfy. This may serve to implement the tax reformists' vision of a comprehensive tax base, but it misses altogether the underlying source of tax law complexity.

## VI. CONCLUSION

If interest group politics and incrementalism long have been thought to define politics as usual in the area of tax policy, nevertheless, it has been the periodic bursts of exceptional politics—reformism—which have come to shape most dramatically the course of tax law since the late 1970's and early 1980's. Indeed, the most significant sources of tax reform in the 1980's were the political entrepreneurs and tax experts who succeeded in dramatically reshaping the tax laws, and not the special interests and their lobbyists. Recognition of the new reality of these extraordinary sources of policy change is lacking among those who focus too closely upon incrementalism and interest group pressures. Furthermore, much of interest is missed by assuming cynically that the intention of all those who pursue a particular tax policy is simply to serve some unseen, but irresistible special interest group. The politics of tax policy in the 1980's, like that of most public policy, was inherently richer and more complex, and it should be expected that the politics of tax policy in the 1990's will be no less so.

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freed from much of the recordkeeping, paperwork, and computations that were required under prior law.").

<sup>164</sup> The alternative view, which conforms with the view expressed in this article, was succinctly and eloquently stated as follows: "[T]he tax law should develop through judicial construction of general principles (in essence, as common law) rather than through ever more complicated prescriptive rules." Peter C. Canellos, *Acquisition of Issuer Securities by a Controlled Entity: Peter Pan Seafoods, May Department Stores, and McDermott*, 45 *Tax Law.* 1, 14 (1991).