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A CRITICAL VIEW OF TRADITIONAL TAX POLICY THEORY: A PRAGMATIC ALTERNATIVE

Nancy E. Shurtz†

I. Introduction

Existing tax policy taken as a whole is inarticulable and theoretically incoherent, and thus, in effect, an obstacle to effective tax reform. To develop a tax policy useful in the development of a tax system, the theoretical approach to taxation must be abandoned and a pragmatic approach must be adopted. Since the inauguration of the income tax in 1913, the tax system has been in a constant state of change. The tax code has been the object of endless analysis. Several major tax reform acts and innumerable minor revisions have been enacted to improve it.1 Yet despite these efforts at reform—or perhaps because of them—it is less clear now than ever before precisely what federal income tax policy is; and the tax code, the visible manifestation of that policy, has grown increasingly complex.2 It should therefore be clear that there will never be successful tax reform, reform which results in an acceptable and essentially completed tax code, one unneedful of and resistant to continual further reform, until there is tax policy reform resulting in a normative tax policy.3 Moreover, it should be apparent that if there is to be a truly normative income tax policy, it is only going to be achieved by taking a different approach from that which has been pursued in the past. What this means, and what approach to income tax policy is necessary in order to effect successful long-term tax reform, are the focus of this article.

The theses of this article are: 1) the present income tax sys-

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2. The incredible complexity of the federal income tax system is a source of annoyance and frustration to all. Federal Income Tax Simplification 3-5 (C. Gustafson ed. 1979) [hereinafter cited as Gustafson]. As the system grows even more complex, the taxpayer's ability to comply becomes less predictable and enforcement becomes less uniform. Id. at 4.

3. A normative tax policy is one that is useful in formulating a tax code, because it is coherent and articulable.

(1665)
The tax system is flawed because it is not based on a normative tax policy; 2) a normative tax policy requires abandonment of the traditional theoretical approach to taxation and adoption of a pragmatic approach and 3) a pragmatic approach must be adopted employing as its primary guiding principle the efficient collection of revenue and employing empirical data to measure whether these revenue goals are being met. This article explores this pragmatic alternative, and considers the effects on the tax base, tax unit and tax rates of such an alternative.

II. Traditional Theoretical Approach

Because it is incumbent upon tax policy to guide tax system reform, tax policy itself must be reformed first. Fortunately, it is not necessary to identify what is specifically wrong with the tax code to understand and correct the shortcomings of past policy. Nor is it necessary to undertake a comprehensive review of past policy to understand how the present tax policy and code evolved into their present condition. The shortcomings in federal income tax policy are the direct result of the approach traditionally taken by the tax specialists instrumental in its development.

The traditional theoretical approach to tax policy formulation has not been useful as a guide to actual decision making. To be useful, it must be well-articulated and theoretically coherent. It must be articulated so that it can provide guidance for reform and contribute stability to the resultant scheme. If the tax policy is unclear, it will be impossible to codify that policy. Furthermore, vagueness in tax policy will result in the tax system being subject to endless revision as one or another tenet of policy is pushed to dominance by potential beneficiaries of the ensuing "corrections" to the code. For similar reasons, tax policy must be coherent. In other words, regardless of which tenets of taxation are determined to be important, it is essential that they be forged into some overall order or be given determinable weights. It is unrealistic to believe that a tax policy which contains unresolved

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4. See, e.g., Karson, Tax Expenditures and Tax Reform, 38 Vand. L. Rev. 1397 (1985). The author remarks upon how "[i]t has become standard political rhetoric to hurl accusations of complexity at the income tax system." Id. at 1402; see also A.B.A. Sec. of Tax’n Committee on Basic Tax Structure and Simplification, Bradley-Gephardt and Kemp-Kasten Bills, 38 Tax Law. 381 (1984) [hereinafter cited as A.B.A. Sec.]. The report notes that two causes of the "current complexity" are provisions narrowing the tax base and taxpayer avoidance of high marginal rates. Id. at 386.
cross-purposes can ever be sufficiently well-defined to be useful in developing a tax structure.

Simply stated, traditional tax policy criteria are not normative for two reasons. First, the criteria are primarily conceptual in nature; their meaning is subject to differing interpretations and are not useful as a guide to real world decision making. Second, the tax policy criteria are theoretically inconsistent.

The traditional approach to tax policy is a theoretical one. One of the major tenets of traditional tax theory has been that there are a multitude of general and specific purposes that should be served by the tax system. The general purposes can be broken down into seven categories: 1) to finance government expenditures; 2) to achieve a practical and workable income tax system; 3) to promote stability and economic growth; 4) to impose equal taxes upon those who enjoy equal incomes; 5) to refuse economic inequality; 6) to minimize interference with the operation of an efficient economy and 7) to develop a tax system consistent with the Constitution and the political system. For simplicity, we can designate these purposes or criteria as follows: revenue-raising; administerability; stability; horizontal equity; vertical equity; neutrality and political order. In addition to these general purposes, traditional tax theorists agree that the tax system has been used to create special incentives. Thus, for example, the tax system has been used to promote charities, energy


6. These purposes have been labelled by Sneed as “macro-criteria.” Sneed, supra note 5, at 568. The author sets up the following guidelines useful to governments in designing their tax systems: 1) the base upon which a tax is levied “should consist of stable and easily identifiable features of the social and economic order;” 2) the structure and burden of a tax should be “sufficiently light and compatible to prevent substantial distortion of those features which constitute the base;” 3) the “pain of paying taxes should neither be maximized nor eliminated;” 4) “use of the taxing power to encourage or discourage specific conduct . . . [should be done intelligently and with] restraint” and 5) the allocation of the tax burden should reflect the goals of the “dominant groups.” Id. at 567.

7. For a discussion of these criteria, see infra notes 49-50 and accompanying text.


9. Anthoine, Deductions for Charitable Contributions of Appreciated Property—The
production\textsuperscript{10} and a healthy environment.\textsuperscript{11}

The general tax policy criteria describe in vague terms the effects of income taxation which must ultimately be balanced in a stable tax system. But they do not facilitate the determination of what elements ought to be combined to produce that system. There is no meaningful way in which traditional tax theorists can judge whether the theoretical tenets that they identify are in fact valid tenets of tax policy. There are no positive indicators of when a tenet of tax policy needs to be rethought.\textsuperscript{12} The fundamental flaw in the traditional approach is that the general tax policy criteria are too diffuse to serve the purpose of translating goals into a tax code.

Traditional tax policy is not normative because no agreement


12. When a particular code provision is abused by taxpayers or is the subject of unfavorable court rulings, the IRS knows to revise or delete it. A major theme of this article is that before such action is taken more empirical evidence must be gathered to determine whether the system is working properly.
exists as to the meaning of the criteria. While there is general agreement in the law and literature that the general criteria should be used in analyzing the tax structure, there is strong disagreement over the applied meaning of the criteria. Perhaps the meaning of horizontal equity has generated the most controversy. Horizontal equity can be generally defined as requiring that persons with substantially the same income pay the same tax.\textsuperscript{13} While tax theorists agree that those who are equal should bear equal tax burdens, they disagree as to how to establish who is equal. Traditionally, "income" has been the basis for comparing equality, however, there is little agreement as to the proper definition of income.\textsuperscript{14} Historically, tax specialists have considered a "good" definition of income to be the "indispensable intellectual foundation" of tax policy, and thus they searched for an intellectual definition.\textsuperscript{15} However, it was not easy to devise a workable definition of income.\textsuperscript{16} Nevertheless, most American tax specialists have accepted a theoretical economic definition known as the Haig-Simons definition, which states that income is "the sum of consumption and the change in value of property."\textsuperscript{17} In short, "income" for theoretical tax policy purposes is the sum of consumption and accumulation.\textsuperscript{18}

Much of tax policy debate over the years has focused on the Haig-Simons definition of income. For example, the comprehen-
sive tax base debate of the 1960’s was an attempt at a definition of income that would be rational, and would provide equality of tax treatment among taxpayers when applied. But what does the Haig-Simons definition contribute with respect to the design, implementation, or administration of a real tax systems—one that actually generates revenue to offset government expenditures? The answer is, unfortunately, nothing but complexity. Because it is theoretical, the Haig-Simons definition cannot be used in any income tax equation. Accordingly, two other definitions of income, “gross income” and “taxable income” have been created in order to administer the tax system, neither of which conforms with the Haig-Simons definition. In fact, in trying to apply the Haig-Simons definition, tax theorists have created the widest possible gap between the definition of income for tax policy purposes and what actually is taxed, or “taxable income.”

One commentator has written that “any relation of taxable income to economic income must be put down as largely coincidental.” Unfortunately, the sole function of that “reality gap” thus far has been to provide room for academics to debate, politicians to maneuver, and special interests to manipulate tax policy.


21. Boris Bittker summarized the comprehensive tax base debate by stating that the concept of fairness cannot be defined in unambiguous terms. See generally Bittker, A “Comprehensive Tax Base” as a Goal of Income Tax Reform, 80 Harv. L. Rev. 795 (1967).

22. Louis Eisenstein noted that any definition of income only succeeds in reflecting personal preference or ideologies, and that “no larger wisdom is discernible.” L. Eisenstein, The Ideologies of Taxation 193, 197-98 (1961).


25. Ideologies coalesce to fashion a tax system that provides economic as well as political stability. See J. Galbraith, American Capitalism: The Concept of Countervailing Power (1952).


27. As Louis Eisenstein states, “[o]ur income tax is doomed to be an elabo-
Hence, nothing could be less conducive to the development of a well-articulated, coherent tax policy or tax system than the Haig-Simons theoretical definition of income.

Another controversial criteria is that of vertical equity. The goal of vertical equity is to insure that persons who have larger incomes pay greater amounts of tax. Thus, to some extent, vertical equity is to be determined by the difference in income between individual taxpayers. Tax theorists generally agree that each taxpayer should contribute his or her "fair share" to the cost of government. No agreement exists as to how the term "fair share" should be defined; there are those who believe a "fair share" is determined proportionately by a flat rate, while others believe in some kind of progression. To date, "fair share" has been set within an ability-to-pay framework, with ability-to-pay being defined as the "capacity for paying without undue hardship on the part of the person paying or an unacceptable degree of interference with objectives that are considered socially important by other members of the community." Because there are no objective criteria pursuant to which differences in ability to pay can be taken into account, the ability-to-pay concept is so ambigu-

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rate hodge podge as long as it represents an uneasy compromise among contesting interests." L. EISENSTEIN, supra note 22, at 455. As Rep. Dan Rostenkowski, D-Ill., Chairman of the House Ways and Means Committee says, "[t]ax reform, like all massive changes in policy, is negotiated, not dictated. Like it or not, tax reform ends up a series of compromises. No compromises, no reform . . . ." Birnbaum, Rostenkowski Says Tax Bill Is To Be Ready This Month, Rejects Reagan's Criticism, Wall St. J., Nov. 8, 1985, at 54, col. 1.


32. The "ability to pay" framework is related to a tax base defined in terms of either income, consumption or wealth.

ous that it lacks practical content. sup 34

There is similar disagreement over the economic criteria of stability and neutrality. On the one hand, the tax system is supposed to serve stability and economic growth. This means the tax system should be used to, for example, promote full employment, price stability, and an increase in the gross national product ("GNP"). On the other hand, the tax system is supposed to be neutral as to the economy. This conflict between stability and neutrality can be seen in the debate over the accelerated depreciation deduction system ("ACRS") and the investment credit ("ITC"). sup 35 These two tax provisions were originally enacted to encourage capital formation. The depreciation deduction has been regularly revised to provide more benefit to the taxpayer. Because evidence exists that these provisions distort the economy and discriminate against certain businesses, the depreciation deduction has been substantially reduced and the investment credit eliminated. sup 36 Few authorities thoroughly analyze the economic aspects of tax policy, sup 37 and those that do disagree considerably over the extent to which the tax system should be used for economic purposes and whether the tax system should serve economic efficiency. sup 38

34. Blum & Kalven, supra note 31, at 64.
37. Hansmann, The Current State of Law and Economics Scholarship, J. Legal Educ., 217, 221-23 (1983). In his article, Hansmann surveys areas of the law in which law and economics scholarship has taken root as well as other areas in which it has not. In the area of tax, the author finds very little law and economics scholarship. Id. at 221. He quickly adds that there is a plenitude of lay economics literature which is directed toward policy issues. Id. However, he notes that legal taxation scholars do not write in economics terms; instead, they write in a "lawyerly" fashion. Id. at 221 n.12 (referring to Clark, The Federal Income Taxation of Financial Intermediaries, 84 Yale L.J. 1603 (1975) (clarifies tax policy concernign financial intermediaries)). He further attempts to explain the lack of law and economics scholarship in tax as due to the delayed effect of the recent development of public finance reaching lawyers. Id. at 222. Hansmann concludes that he expects tax will become a major area of growth for law and economics scholarship. Id. at 223.
38. Barker & Kieschnick, Taxes and Growth, 23 Tax Notes 629 (1984); Bittker, Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities?
The second reason traditional tax policy is not normative is that the criteria are contradictory. Because traditional tax policy criteria represent social and economic as well as revenue raising objectives, conflicts among the policy criteria are frequent and unavoidable. Traditional tax policy analysis is predicated upon shifting theoretical tenets. Thus, regardless of how facially persuasive a particular analysis might be, no analysis could ever be compelling because it would be unclear whether the tenets of tax policy which served as its foundation were not subordinate to conflicting tenets which compelled a different result.

The tax policy literature is replete with these conflicts. For example, administerability clashes with horizontal equity when imputed income is not taxed. Vertical equity clashes with administerability because progressive rates cause income-shifting and income-bunching. Neutrality clashes with administerability when capital gains are not taxed like ordinary income. Horizontal equity clashes with neutrality when interest and savings are taxed. Vertical equity clashes with neutrality when high tax rates

16 San Diego L. Rev. 735 (1979) (also in The Economics of Taxation (H. Aaron & M. Boskin eds.) (1980)); see, e.g., Ackerman, Unfair Competition and Corporate Income Taxation, 34 Stan. L. Rev. 1017 (1982). Ackerman analyzes the public policies that differentiate firms on the basis of organizational form, namely competition between non-profit and profit entities. Id. at 1019 n.9. The author implies that the tax related issues for non-profit entities raises questions regarding economic efficiency, and concludes that tax on non-profit "unrelated" business income creates more problems than it initially sought to prevent and, therefore, should be repealed.


cause taxpayers to choose leisure over labor.\textsuperscript{43} Vertical equity clashes with horizontal equity because certain deductions necessary to a policy of taxing only income in the Haig-Simons sense are worth more to taxpayers in higher brackets than those in lower brackets.\textsuperscript{44}

Since almost any general or specific reform measure will have conflicting consequences it is impossible to determine the proper reform under traditional tax policy criteria.\textsuperscript{45} Ordinarily, tenets of policy are revised or deleted when they conflict with superior tenets, which, in turn, requires the determination of a hierarchical order to be given the criteria. This would seem to be applicable to the criteria of federal income tax policy because there are frequent and unavoidable conflicts among them.\textsuperscript{46} But traditional tax policy makes no pretense of establishing a normative hierarchical order. It does not attempt to reconcile or eliminate conflicting criteria, nor does it give any quantifiable weight to the criteria. The traditional tax policy literature indicates that each of the existing criteria should be included in tax policy.\textsuperscript{47} Consequently, these traditional theorists are constrained by the theoret-


\textsuperscript{45} For a discussion of the various attempts made at tax reform and the diverse theoretical approaches thereto, see infra notes 54-55 and accompanying text.

\textsuperscript{46} Nevertheless, attempts have been made to untangle the complexity of the federal income tax system and to create methods of achieving a meaningful and simplified system. See Gustafson, supra note 2.

\textsuperscript{47} Sneed, supra note 5, at 574. Sneed states that it is obvious that frequent unavoidable conflicts between the criteria notes are unavoidable. Id. at 599. He emphasizes that it is impossible to consider all criteria equally important at all times and in all places. Id. at 601. Although he suggests that the solution is to rank the criteria, Sneed realizes that such ranking can never remain fixed. The subjective test Sneed employs to rank the criteria “must be done by intuition, illuminated by intelligence and guided by integrity.” Id. For Sneed’s general ranking of the criteria, see infra text accompanying note 49.
ical approach to accept each and every one of the conflicting criteria as valid criteria of tax policy. Once tax theorists have reduced the tax system to its theoretical tenets, there is no basis on which to distinguish among them. In theory, each criterion is valid.

An example of the problem with the traditional criteria is provided by Sneed's classic article *The Criteria of Federal Income Tax Policy*. In that article, he attempts to order the general criteria into what he terms "macro-criteria" as follows: First echelon: administerability (which he calls practicality) and horizontal equity (which he calls equity); Second echelon: neutrality (which he calls free market compatibility) and political order; Third echelon: vertical equity (which he calls reduced economic equality); Fourth echelon: stability and Last echelon: revenue raising (which he calls adequacy). In addition, Sneed recognizes numerous specific "micro-criteria" of tax policy.

After ordering the macro-criteria, Sneed proceeds with a "demonstration," in which he applies his tax-policy ordering to evaluate the tax law with respect to the treatment by corporations of capital contributions by those other than shareholders. Ex-

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48. See generally Sneed, *supra* note 5, at 567. Sneed states that because clashes among the criteria are so likely to occur, the importance of choice is crucial. *Id.* at 595. He then goes on to demonstrate several examples of criteria conflict, and offers his view as to which criterion, if any, should be subordinated to others. *Id.* at 599-601.

49. *Id.* at 568. These seven "paramount" purposes may be implemented as a measure for the whole income tax structure. Sneed describes the seven criteria in great detail and demonstrates how each plays an integral role in the income tax system. *Id.*

50. *Id.* Sneed describes micro-criteria as "less pervasive more particularized ends." *Id.* He concludes that because macro-criteria cannot exhaust all federal income tax purposes, the micro-criteria are necessary to round out general guidelines to the federal income tax. *Id.*

51. *Id.* at 608-12. The following excerpts from Sneed's demonstration reveal how well the criteria "function with useful precision in evaluating the income tax":

[T]he advantage of [an alternative to present tax treatment], if any, appears marginal . . . . Equity is more troublesome . . . . A fair conclusion is that Equity calls for a precise measurement which in some instances cannot be made. This suggests that the choice is between undertaking a task in which inaccuracy in performance frequently may be the result and adopting a structure which avoids a difficult task but which also compromises the standard of Equity . . . . Free Market Compatibility also offers somewhat ambiguous guidance . . . . Adequacy . . . is of course involved, [but not significantly] . . . . Reduced Economic Inequality sounds no loud and clear notes . . . . Stability offers little help beyond the vague observations that the sections [sections 118 and 362(c) of the 1954 Code] probably reduce some investments . . . . Nor is Political Order of much greater assistance . . . . Finally, signifi-
cerpts from the demonstration reveal that the criteria do not in fact "function with useful precision in evaluating the income tax." Sneed's language illustrates both the contradictions inherent in the traditional criteria, and the first point made above, i.e., that theoretical criteria have no relevance to real world decision-making. Apparently Sneed anticipated some criticism, for he concluded: "with this the demonstration of the application of the macro-criteria ends. The impatient will feel their utility is inadequate because no clear answer was unmistakably dictated, but this misconstrues their function. They serve only to assist the act of human judgment, not to supplant it." In spite of Sneed's assertion, however, his macro- and micro-criteria do not serve to "assist human judgment," for in the aggregate they are not normative in the heuristic sense.

The above argument should not be taken to mean that diverse goals are necessarily fatal to the creation of a truly normative tax policy. Even goals which are so diverse as to be inconsistent will not be fatal if there is a way to choose among them, either by weighing them or arranging them in an unequivocal order of predominance. But present income tax policy fails to do this, as revealed by an examination of the tax policy literature. In sum, the present tax policy is an ill-defined mixture of ad hoc tax, economic, and social policies which are theoretically incoherent.

The "new public finance" scholarship is an attempt at reconciling the opposing criteria of equity and allocative efficiency. The scholarship uses economic analysis to make assumptions which isolate limited issues for analysis. The theory behind the scholarship is to use assumptions and narrowly define the issues to gain insights and certainty not otherwise attainable if all economic variables are considered. However, this scholarship, like cant applicable micro-criteria do not appear to exist... On balance it appears that neither the existing structure nor its [alternative] wins unqualified approval.

Id. at 608-12.

53. Id. at 613.


55. For a review of the literature, see Feldstein, On the Theory of Tax Reform, 6 J. Pub. Econ. 77 (1976).

the traditional tax scholarship, is ultimately derived from the criteria of equity and efficiency and as such involves the same moral value judgments as traditional tax policy.57

III. THE PRAGMATIC APPROACH

A theoretical approach which is ineffective in the development of a normative income tax policy, and therefore is an impediment to successful tax reform, must be abandoned in favor of a workable approach. But what approach should be taken? One of several available approaches is a pragmatic approach that adopts as its major tenet the efficient collection of tax revenue.58 The approach is pragmatic because it focuses on what works from the standpoint of administrative feasibility. Its goal is to establish a workable tax system that yields the most revenue for the least amount of administration costs.59 A highly beneficial result of concentrating on the efficient collection of revenue as a guiding principle is that the tax system becomes susceptible of monitoring to determine if its purpose is in fact being achieved.60

At its inception, the primary function of the income tax was to raise revenue.61 Only in the late 1930's did Congress begin to assert that the income tax should be used to shape the economy and to accomplish social objectives. Slowly, the pursuit of these objectives became considered as important as raising revenue.62

57. For a sum of the sources of this economically favored tax reform and tax policy scholarship, see supra note 54.
59. For a discussion of how a pragmatic approach would develop a "calculus of utility," see infra notes 143-47 and accompanying text.
60. See generally Feldstein, supra note 55, at 77.
61. Calkins, A Federal Income Tax Designed for Revenue Only, 23 Tax Notes 201, 202 (1984). Calkins points out that since 1916 when the Revenue Act was born out of the necessity to outfit an army and a navy, the raison d'etre of the federal income tax system has been to raise revenue. Id. The uncertainty over the federal tax system's capacity to continue raising revenue has only recently become a question. Id. at 200-205.
62. Id. at 202. In the late 1930's, Congress began to think in terms of utilizing the system of federal taxation to shape the economy. Id. The first suggestion of this motivation appeared in the report of the Ways and Means Committee on the Revenue Bill of 1938. Id. (citing H.R. Rep. No. 1860, 75th Cong., 2d Sess., 1939-1 C.B. 728). In reporting the Revenue Bill of 1941, the Ways and Means Committee stated:

It has been your Committee's aim and desire to distribute the additional tax burden as equitably as possible among the several classes of taxpayers. Due consideration has also been given to the economic and social effects of the increased levies. There was continually in mind the
As a consequence, the size and number of tax exemptions and deductions in the Code increased. Some of the economic objectives were to encourage capital formation,\textsuperscript{63} to promote the development and protection of our natural resources\textsuperscript{64} and to prevent placing United States business at a competitive disadvantage to firms in other countries.\textsuperscript{65} Some of the social objectives were to promote charities,\textsuperscript{66} to encourage the purchase of residences,\textsuperscript{67} to foster the development of employee retirement funds and health benefits\textsuperscript{68} and to prevent hardships due to casualty and medical expenses.\textsuperscript{69} In addition to these economic and

\begin{itemize}
\item need for keeping to a minimum, consistent with our defense efforts, any disruption of our economy, and, at the same time, supplying a needed restraint upon inflationary tendencies.
\item \textit{Id.} (quoting H.R. Rep. No. 1040, 77th Cong., 1st Sess., 1941-2 C.B. 413). In the following year, the Committee recommended still further increases, stating: \textit{It is thus apparent that our revenue needs are extreme and your Committee have [sic] endeavored to secure every dollar of additional revenue which, in its opinion, the national economy can bear. In its effort toward this objective, however, care has been exercised in every instance not to place an unbearable burden on any taxpayer.}
\item 63. \textit{Id.} at 203. The crucial decade was the 1960's; in the early years, concern had arisen that the economy was slowing down. \textit{Id.} The Kennedy Administration began what would become a trend by introducing an investment credit to stimulate capital investment in productive facilities—use of the income tax to mold the economy. \textit{Id.} The Secretary of the Treasury stated:
\begin{quote}
This matter has top priority in the agenda for tax reform. As chief financial officer of the Nation, I do not lightly regard tax abatements on the scale proposed here. I urge this legislation because it will make a real addition to growth consistent with the principles of a free economy; because it will provide substantial help in alleviating our balance-of-payments problem, both by substantially increasing the relative attractiveness of domestic as compared with foreign investment and by helping to improve the competitive position of American industry in markets at home and abroad; and because, far from adding to the forces responsible for alternative recessions and recoveries, it will be of major assistance in strengthening our present recovery and enabling us to attain a higher rate of growth and sustained full employment. Early action will resolve uncertainty or hesitancy and begin at once a strong and lasting incentive for modernization of the productive facilities of our national economy.
\end{quote}
\item 64. \textit{Id.} at 204-05.
\item 65. \textit{Id.} at 204. For example, one of the claimed goals of the Revenue Act of 1971 was that it was designed to increase our exports and improve our balance of payments. \textit{Id.} (citing H.R. Rep. No. 533, 92d Cong., 1st Sess., 1972-1 C.B. 498).
\item 66. \textit{Id.} at 203. \textit{See, e.g., I.R.C. § 170 (West Supp. 1986).}
\item 67. Calkins, \textit{ supra} note 61, at 205. It was suggested that legislation be introduced to support the use of "tax-exempt financing" to facilitate home ownership. \textit{Id.}
\item 68. \textit{Id.}
\item 69. \textit{Id.} at 213-14; \textit{see, e.g., I.R.C. §§ 104, 213 (West Supp. 1986) (Compen-
social objectives, preferences were enacted into the Code to benefit special interests, such as farmers, financial institutions, the military and ministers.

The consequence of special interest and economic and social legislation has been to steadily narrow the tax base and to progressively disable the income tax as a principle source of federal revenue. Using the federal income tax to guide the economy through selective reductions in, and deferrals of, tax can contribute to serious problems of perceived unfairness, noncompliance and complexity. It may also be counterproductive in the pursuit of its stated objective: the improvement of the economy.

The development of any tax policy must begin with the recognition of fundamental rules. Three such rules underlie the pragmatic approach. The first is really a statement of purpose, and thus serves as the ultimate standard in evaluating any federal tax: *The sole origin and merit of any tax system lies in its utility for raising revenue to offset government expenditures.* This has nothing whatever to do with theory, it merely states the historical fact: taxation is a method of financing government. Under a pragmatic approach to tax policy the major focus of the tax system would be upon reversion for injuries and sickness; medical expense deduction; id. § 165 (casualty loss deduction).


74. See Calkins, *supra* note 61, at 210. Tax incentives, although intended to stimulate the development of small business under the theory that a reduced capital gains rate will encourage investors to provide capital therefor, may be having adverse effects. *Id.* Reduced rates of capital gains tax also encourages investment in land, gold and collectibles, none being directly productive of income or employment. *Id.* The use, therefore, of the federal income tax to guide the economy may actually be a counter-productive influence on economic development. *Id.*
nue raising. Under this approach a conclusion would be reached as to how much revenue must be raised but not as to the proper source of funds. The President and Congress could establish the revenue level desirable for all direct expenditures and the tax systems would be devised to efficiently collect the revenue for the workings of the system.

The second fundamental rule of a pragmatic tax policy is a necessary corollary to the first rule: *A tax scheme that is practical is a necessary and co-extensive part of one that efficiently raises revenue.* Practicability implies three things: 1) convenience and ease of assessment and collection; 2) structural unity and simplicity and 3) certainty of obligation.75 It is clear that revenues are not going to be maximized unless there is relative ease of collection. Collection is made easier when the tax system is simple and not subject to frequent change. In addition, anything that adversely affects compliance limits the effective tax base.76 The single most significant factor in this regard is complexity. When the complexity of the tax system increases, the system becomes more difficult to administer, which inevitably results in increased intentional and unintentional noncompliance.77 Certainty of obligation comes with a simple and completed tax code, one not requiring constant change.

The third fundamental rule of a pragmatic tax policy is of an operational nature: *Taxation causes adverse social and economic effects*

75. See Sneed, supra note 5 at 572-73. For another view of how simplification of the Code will achieve these three components of practicability, see generally Gephart & Wessel, Tax Reform: A “But-For” Test 29 St. Louis U.L.J. 895 (1985).


which operate to delimit the taxable capacity of every tax base, thus social and economic effects which reduce the taxable capacity of a tax base should be minimized. This rule can also be inferred from a historical study of taxation, but essentially it is a logical conclusion supported by the weight of authority. That the dynamics of taxation cause social and economic side effects is beyond question. Such side effects can be “adverse” and thus can create limits to the taxable capacity of the tax system. Under the pragmatic approach economic and social goals would be pursued by direct means via governmental subsidies.

The adverse effects of taxation operate to limit the taxable capacity of an income tax by restricting the tax base. Income taxation itself retards economic growth, which limits the available tax base. Both the effective rate of taxation and the rate of progressivity work to restrict incentives for productive activity and investment, and reduce the net after-tax return between risky and safe investments, thereby influencing investment decisions. Furthermore, any of the adverse effects of taxation may make it politically or economically necessary to redefine the tax base more narrowly, which again limits the available tax base. One of the most significant factors having this latter effect is the perception

78. See Gustafson, supra note 2, at 3-4; see generally Smith, supra note 8.
79. See generally Federal Taxation, supra note 5. Although traditional tax policy theorists characterize the introduction of general and specific criteria of tax policy emphasize their positive aspects, in every case their possible aspects are indirectly derived from negative effects that flow directly from the taxation. Perhaps the most obvious case is the criterion of neutrality. Almost all tax theorists would admit that taxation, by its very nature, will slow economic growth, yet the goal of neutrality is simply to affect the economy as little as possible.

The nature of the other criteria is negative as well. For example, each of the specific criteria goals representing ad hoc economic policies can be implemented through favored tax treatment of particular economic activities, but only because continuing repressive economic effects make alternative economic activities unattractive. It is the same with the implementation of social policies, as, for example, the general criteria of vertical equity and the specific criteria of charitable giving. Vertical equity may be desirable, but it can only be achieved through taxation by disproportionately reducing the economic resources of higher income groups. And charitable giving, a highly regarded goal, is stimulated through the tax system only because it can be made to serve as a tax-avoidance mechanism. Thus, regardless of what beneficial social and economic purposes can be promoted through manipulation of tax, their effects on taxation operate to limit its capacity to raise revenue. Consequently, a tax system should be adopted that has as its primary function the raising of revenue, not the promotion of economic or social goals.

of unfairness, which stimulates ameliorating tax expenditures.81 The enactment of special economic and social incentives has the same effect.

The taxable unit can also operate to limit the taxable capacity of the income tax. For example, the elimination of the corporate tax would substantially reduce tax revenues. Under a progressive income tax system where a standard deduction is allowed, the aggregation of income of a family into one taxable unit would raise tax revenues. On the other hand, when smaller taxable units in such a system are allowed, such as trusts and dependent children, less revenue would be collected.

Tax rates can operate to limit the taxable capacity of the income tax. This occurs when the effects of the tax increase cause a decrease in the effective tax base (through a decrease in compliance and/or the actual tax base) that more than offsets the effect of the rate hike. The absolute limit of taxable capacity is that point at which an increase in tax rates would result in a decrease in total revenue. In practice, however, the absolute limit could probably never be reached. Instead, there are lower political limits to taxable capacity where the adverse political and economic effects of a tax increase would more than offset the benefit derived from the additional revenue.82 While the political limits of taxation may manifest themselves differently,83 they nevertheless are a function of the same dynamics of income taxation which

81. “Tax expenditures” represent taxes being “spent” (through being lost to the tax system) to achieve specific nontax goals. See Tax Policy and Tax Reform: 1961-1969, 170-71 (F. Hallmuth and O. Oldman, eds. 1973) (compilation of selected speeches and testimony of Stanley Surrey) [hereinafter cited as Tax Policy and Reform]; see Gustafson, supra note 2; Smith, supra note 8, at 9. Some countries have continued their dynamic economic growth despite high taxation. Id. at 8. Others have either stagnated or never really shared in the world’s expanding productivity. Id. Apparently, the secret of economic vitality is not solely dependent on the tax system. Id. The combination of economic, social and political forces determine whether “the environment will foster such entrepreneurial talent as may exist in a country.” Id. at 8-9.

In the area of investment, taxation modifies the rewards. Id. Smith explains that “[h]igh income taxation by reducing the net differential between risky and safe investment, tends to drive funds from the former [risky] to the latter [safe].” Id. He adds that a “favorable treatment of gains” could pull in the opposite direction. Id.

82. See Gustafson, supra note 2, at 3-4. For a discussion of the structure of the tax system related to its social purposes see supra notes 5-6 and accompanying text.

83. Such political limits operate in two ways: first, by influencing the fiscal policy decisions regarding total expenditures and the revenue-debt mix of financing expenditure to create, in effect, a maximum allowable revenue target; and second, by influencing how the tax burden can be distributed.
limit the system's absolute capacity. Thus, either through repressive economic effects that shrink the "economic pie" and directly erode the tax base, or through various effects that indirectly erode the tax base, the side effects of income taxation ultimately operate to delimit its capacity to raise revenue. Thus, regardless of what beneficial social and economic purposes can be promoted through manipulation of tax rates, their effects on taxation operate to limit its capacity to raise revenue.

It is time that the federal income tax be viewed as a means to raise revenue. That is the way that property and sales taxes are viewed in this country. It is desirable that taxes raise the revenue that is needed, not shape the economy. If one begins to approach the federal income tax from a similar perspective, we will find that it can be made into a fair, reasonably progressive, effective producer of the revenue which the federal government requires. Furthermore, once we have determined that we will not modify the tax to stimulate any particular segment of the economy, we will find that we need to change the law less often. Once we set revenue as our objective, we will find that simplicity is much easier to achieve. No longer will we have to design long provisions to assure that benefits go to the intended targets. As we turn to a practical tax base, rationality will return to the Code and the frequency with which citizens will encounter unexpected results will diminish. Persons similarly situated will more often have similar tax burdens. Those with more income and wealth will, in general, pay more tax in proportion to their income than those with lesser income or wealth. Perceptions that the tax system is fair will increase. It may even be that the willingness of citizens to self-assess and pay their obligation will again begin to grow.

84. See Smith, supra note 8, at 6-10. Smith points out two possible effects of high taxation: the limitation of incentives leading to a curtailment of production and the potential to restrict private spending to offset government spending. Id. at 6.

85. See generally id. at 11-14. Smith recognizes that economists must consider not only "what might be theoretically possible if people would behave as we might wish them to (and as we think they should)," but also political behavior actualities. Id. at 11.


87. In a general sense, the impetus of this article is to demonstrate the soundness of this proposition. For a discussion of a similar proposition, i.e. that numerous selective reductions in and deferrals of tax contribute to serious problems of complexity, see Calkins, supra note 61, at 210.
IV. Why a Pragmatic Approach Is Necessary

The major criticisms of the present income tax system follow traditional policy grounds. These are: 1) it is unfair; 2) it is too complicated and 3) it unnecessarily retards economic growth. A pragmatic tax system would help to alleviate all these problems.

Perhaps the single most common complaint about the tax system is that it is "unfair." Thus, the major criticism of a pragmatic approach to tax policy will likely be that it does not take into account "fairness," or horizontal and vertical equity. The concept of fairness has always played a central role in tax policy, because of the perception that unfairness causes dissatisfaction among taxpayers. This adversely affects the tax system both directly through reduced compliance and increased administrative costs, and indirectly through increased political intervention which frequently leads to legislation resulting in a smaller tax base and increased complexity. Nevertheless, "fairness" cannot be a criterion of normative tax policy. Even though there may be widespread concurrence about the abstract nature of fairness, there is no such agreement over its "applied" meaning. Although most traditional tax theorists equate horizontal equity with the Haig-Simons definition of income, this would serve to define the concept functionally by relating it to how comprehensive the income tax should be to be "fair." Assuming the Haig-Simons definition could be meaningfully applied, does not this treatment only beg the issue, for what would be a "fair" application of the Haig-Simons definition? The unavoidable conclusion is that "horizontal equity," or "fairness," is impossible to define to a degree where it could function with useful precision in evaluating an income tax.88 Hence, "fairness" is, and would always be, a complicating, and thus counterproductive, criterion of income tax policy.

Second, a chronic, if not the most acute, problem of the income tax system is its complexity.89 Complexity causes a variety

88. See Sneed, supra note 5, at 579-80.
89. Structural complexity in the Code (deviations from the comprehensive income base different taxable units, etc) leads to transactional complexity as taxpayers plan to avail themselves of the tax preferences created in the tax structure. Transactional responses are then met with structural changes, which, in turn, are met with new tax planning techniques. Cooper, The Avoidance Dynamic: A Tale of Tax Planning, Tax Ethics and Tax Reform, COLUM. L. REV. 1553 (1980); Galper & Kaufman, Simplification and Comprehensive Tax Reform, in OFFICE OF TAX ANALYSIS PAPERS No. 34 (1978) (U.S. Treasury Department). An example of this is the time value of money rules enacted by the Tax Reform Act of 1984 as a response to tax planning transactions entered into to take advantage of tax
of adverse effects, all of which operate to reduce the efficiency of the tax system. At a recent conference on this issue it was concluded that "the burdens of income tax complexity on taxpayers and government alike constitute a danger to the health of the income tax system and to this nation's continued reliance on self-assessment and voluntary compliance."90 Thus, one objective of tax policy has to be to simplify the Code. Unfortunately, since complexity is inherent in every statutory scheme, there are limits to simplification. Nevertheless, a pragmatic approach to tax policy can achieve significant simplification by reducing the complexity in the Code that has been introduced as a product of theoretical tax policy.

There are basically two categories of tax code provisions, "structural" provisions and "special" provisions. Structural provisions are those which are necessary to implement a tax on income. Special provisions are those that define "taxable income" on bases other than revenue considerations, specifically, social or special economic considerations. Complexity from structural provisions is unavoidable but complexity from special provisions is not, thus a pragmatic tax policy would eliminate special provisions altogether. One analyst summed up the complexity-simplification issue as follows: "The best way to have simple tax laws is to have a simple tax policy. Each added policy requirement usually adds complexity."91 As an example, think of the ironic relationship between "complexity" and "fairness." The complexity of the tax system frequently manifests itself in the form of complaints about unfairness, and yet attempts to make the system more fair inevitably make the system more complex.

Third, a pragmatic approach to tax policy would work to reduce the repressive (macro) economic effects of income taxation. As a start, simplifying the tax system by eliminating special social and economic provisions would redound to the benefit of the economy through reduced public and private costs to administer the system.92 More important, however, the repressive effects of taxation would be systematically reduced through the operation

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90. Gustafson, supra note 2, at 85.
91. Id. at 28 (quoting Ward Hussey, Legislative Counsel in the Office of the Legislative Counsel of the United States House of Representatives).
of a "calculus of utility," for presumably the calculus would be designed to measure whether revenue is being raised efficiently.

More important, from a political perspective, in the past, the tax system has served both to raise revenue and to spend it through tax expenditures, and it has done neither well. However, because of the alarming size of government expenditures in relation to GNP, it has become increasingly important that revenues be raised and spent as efficiently as possible. That will only be accomplished when the tax system is reformed to tax without substantial costs and social and economic policy is left to the appropriations and spending processes. What makes it politically feasible to expunge social and economic policies from tax policy is that fiscal fair treatment of taxpayers is not solely a function of taxation. It is a function of both taxation and spending. And there is growing academic and political awareness that tax incentives are generally inferior to direct subsidies as a means of achieving social goals. Thus, tax reform is only one part of a larger picture, and social policies that are incompatible with efficient taxation can be effected by other means.

Subsidization outside the tax system is the best way to accomplish these social and economic policies. Congress would then be free to optimize subsidization in two ways that are impossible when subsidization is done through tax preferences. First, Congress could give a larger subsidy to poor rather than wealthy persons, thus making subsidization progressive. Such progressive subsidization would further the goals of a progressive tax system rather than working against them. Second, Congress would be able to subsidize some activities more heavily than others. The social value of some subsidized activities is undoubtedly greater than that of others. Congress should be free to more heavily subsidize those activities rather than being forced to subsidize all activities at the same rate through the tax system.

After identifying fundamental rules and determining the need for a change, the next step in developing a well-articulated coherent federal tax policy is to determine what tax system or tax systems should be adopted, and what the general characteristics of that tax system should be. Fundamental characteristics will be

93. For a discussion of the "calculus of utility", see infra text accompanying notes 145-53.

94. See e.g., Gephardt & Wessel, supra note 75, at 908 ("Direct subsidies are a more efficient method of providing relief to those sectors of the economy that public policymakers decide are in need of help."); Calkins, supra note 61 at 211-14 (only purpose of tax should be to raise revenue).
addressed: 1) the tax base; 2) the rate structure and 3) the tax unit.

A. The Tax Base

Under the pragmatic approach, the income tax system would be retained. Traditional tax policy theorists have debated the issue of whether consumption or income is the better tax. Many have argued that a consumption tax better measures a taxpayer's ability-to-pay, because tax-paying capacity is measured over a lifetime perspective as the taxpayer consumes his income and wealth. A consumption tax taxes a taxpayer according to the amount which he takes out of the common pool rather than according to the amount he contributes to it. Consequently, many have argued that consumption is the proper base of taxation since personal consumption is at the expense of government expenditures. Others have argued that a wealth tax added to an income tax is the best tax system because income alone is not an adequate test of ability to pay; nor can that capacity be assessed by a tax based on property alone.

The federal tax that presently raises the most revenue is the income tax. The modern income tax went into effect in 1913 as part of a tariff reform act. It was intended to counterbalance the loss of revenue involved in a reduction of the tariff, which, at the time, was the government's chief source of revenue. The importance of the income tax obviously has grown to where it is now an indispensable source of revenue, and it is safe to conclude that it will never be repealed unless it is proven that it no longer ful-


96. H. Aaron & H. Galper, Assessing Tax Reform (1985). Aaron and Galper argue that taxation of consumption in any given year is a better measure of lifetime ability-to-pay than is taxation of income in any given year.


98. Andrews, supra note 95, at 1121.


100. For a comprehensive history of the federal income tax system, see R. Paul, Taxation in the United States (1954).
fills that purpose. Moreover, if the income tax is ever proven unsatisfactory for raising revenue, it is safe to assume that it will not be perpetuated to serve other purposes. Under a pragmatic approach to tax policy, the income tax would be maintained but improved so that its major focus is that of raising revenue.

The pragmatic approach to defining income for tax policy purposes would not be to search for an intellectual definition like the Haig-Simons definition that traditional tax theorists use, but rather to create a tax-oriented functional definition. If the purpose of taxation is to raise revenue, the tax base must be as broad as possible. And to achieve that objective, tax strategists should analyze the economy to determine which elements would be practical to tax and then design a statutory scheme accordingly. The development of a definition of "taxable income" would be wholly utilitarian and would involve only the determination of what would "work."

Thus, under the pragmatic approach, those business deductions necessary to define income would remain in place. All personal deductions, on the other hand, would be eliminated, since equity would no longer be the guiding principle. No need would exist for the medical expense deduction, the charitable deduction, the mortgage interest deduction, the state and local tax deductions or other itemized deductions. Direct subsidization instead of the tax code, would be used to accomplish social and economic objectives. Under a pragmatic approach, a form of standard deduction would remain. Since the United States government has long had a policy of making transfer payments to those having low incomes, it would be administratively inefficient to tax those with low incomes only to return that income to them in the form of welfare transfer payments. Under the pragmatic

101. The combined individual and corporate income taxes accounted for 45% of the total tax revenue in 1982. Treasury Dep't, 1 Tax Reform for Fairness, Simplicity and Economic Growth: The Treasury Department Report to the President (1984) [hereinafter cited as Treasury I].
102. For a discussion of the Haig-Simons definition of income, see Turnier, Personal Deductions and Tax Reform: The High Road and the Low Road, 31 Vill. L. Rev. 1703 (1986).
104. There may be a constitutional problem, however, with direct subsidization of charities, in light of the first amendment mandate that "Congress shall make no law respecting an establishment of religion." U.S. Const. amend. I.
105. For an argument that the personal exemption should equal the minimum wage, see O'Kelley, Tax Policy for Post-Liberal Society: A Flat-Tax-Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax, 58 S. Cal. L. Rev. 727, 744-51 (1985).
approach, however, the amount of exempt income would be determined empirically. Tax theorists could concentrate on practical questions of tax policy rather than on esoteric issues that have no real-world relevance. Tax policy decisions would be less subject to attack, because practical considerations are relatively unambiguous.

B. The Rate Structure

Analysis of the second major variable of an income tax system, the rate structure, further illustrates the superiority of a pragmatic approach to tax policy. There are two issues involved in creating an income tax rate structure; whether to make it proportional or progressive, and, if the rate structure is to be progressive, how progressive to make it.

The American income tax has always been progressive, yet the theoretical debate over the proportional-versus-progressive issue is nearly 300 years old and there is still no compelling theoretical argument for progressive taxation. In traditional tax policy theory, progressivity is justified in terms of the decline in the marginal utility of money or goods that money can acquire. But the doctrine of marginal utility ignores the possibility that different taxpayers have different capacities for enjoyment and sacrifice. Such differences, however, introduce subjective inquiries not susceptible to precise measurement into the doctrine. One of the most comprehensive modern analyses of this issue was undertaken by Professors Blum and Kalven, who concluded:

The case for progression, after a long critical look, thus turns out to be stubborn but uneasy. The most distinctive and technical arguments advanced in its behalf are the weakest . . . . The case has stronger appeal when progressive taxation is viewed as a means of reducing economic inequalities. But the case for more economic equality, when examined directly, is itself perplexing.

106. See generally Blum & Kalven, supra note 31 (Recognizing that although progressive taxation is proper, its justification rests on tenuous theoretical grounds).


Perhaps a more revealing comment on the role of the theoretical approach to tax policy in this area, however, was made by another analyst who observed simply: "[I]n the historical pattern of [progressive taxation] . . . some of the most rigorous analysis of the principle came after it had become a political reality." What this suggests is, and it is certainly true of the Anglo-American experience, that progressive income taxation is not a manifestation of theoretical tax policy at all, but rather the converse. Hence, even with the benefit of hindsight, theoretical tax policy has been unable to make a convincing case for progressivity.

Pragmatic tax policy, on the other hand, explains, and thereby justifies, the progressive income tax, for progressive taxation historically has been instituted for purely pragmatic reasons. The purpose of taxation is to raise revenue, and a progressive rate structure can raise more revenue from a given tax base than a proportional rate structure can. This "revenue" explanation is, of course, merely another form of the "ability-to-pay" argument. The effective rate of taxation in a progressive system can be increased by increasing the rate of progressivity without affecting lower income groups which would otherwise have to be included in the tax base if a proportional rate were employed to produce the same amount of revenue. But, in either form, the argument is a pragmatic argument, not a theoretical argument in the classic sense. However, because the purpose of taxation is to raise revenue, there is no question but that an efficient income tax system should employ a progressive rate structure. Tax policy should eliminate pretense and justify progressivity as the practical way to raise revenue.

Once it has been decided that the income tax should be progressive, the next issue is how progressive should it be, or in other words, what should the rates be? Progressivity is not an unqualified virtue. Here, again theoretical tax policy provides no help. It is evident that the principal theoretical justification for progressivity, vertical equity, which theoretically militates for a severely progressive rate structure, clashes with another goal, neutrality, which economists agree had a negative impact on the degree of progressivity. Because there is no theoretical basis

110. R. PAUL, supra note 100.
111. Id. at 719-27.
112. See Federal Taxation, supra note 5, at 9.
113. For a discussion of the issue in terms of the "new public finance" scholarship, see supra note 54 and accompanying text.
on which to reconcile the two, the degree of progressivity must be determined in some other manner. The record on this issue suggests that in the past the degree of progressivity has been set more or less arbitrarily depending on the need for revenue.\textsuperscript{114} At the least, the variation between the high rates of progressivity in the past and the relatively low rates of progressivity enacted by the 1981 and 1986 Tax Reform Acts\textsuperscript{115} indicates that theoretical tax policy in this area has been inconsistent. By comparison, pragmatic tax policy provides coherent guidance with respect to progressivity. Pragmatically, the question to be answered is: how should the tax burden be distributed to maximize the income tax's ability to raise revenue from the available tax base? Obviously, this is not an easy question to answer. For one thing, the answer will change according to how much revenue must be raised and thus what the effective tax rate must be. Nevertheless, the normative policy implications are apparent. The degree of progressivity in an income tax structure should be adjusted according to revenue needs and an economic calculus, not social theory.\textsuperscript{116}

While such broad guidelines will not mechanically yield a definitive rate structure, a pragmatic approach would at least facilitate the search for one. First, it would eliminate complicating social policy considerations such as horizontal and vertical equity, for neither offers any useful guidance on the proper degree of progressivity.\textsuperscript{117} Second, establishing the tax structure as a product of an economic calculus rather than politics would tend to divert the public's attention from taxation. Economics is a neutral discipline, in intent if not in effect, so taxpayers burdened by a tax structure prescribed by an economic calculus would be less likely to feel unfairly discriminated against. Moreover, their attention would probably be turned toward the expenditure side of the budget, where arguments about fiscal and social policy belong. Not only would this create a favorable climate for the develop-

\textsuperscript{114} See R. Paul, \textit{supra} note 100.


\textsuperscript{116} Prevailing economic theory suggests that the higher the effective tax rate, the less progressive the income tax should be to maximize economic efficiency and total revenue. See \textit{Studies in Taxation, Public Finance and Related Subjects A Compendium} 9 (1983).

\textsuperscript{117} See generally Blum & Kalven, \textit{supra} note 31.
ment of an efficient income tax, but it might also contribute to
greater fiscal responsibility by shedding more light on the overall
fiscal picture.

C. The Taxable Unit

Analysis of the third major variable of an income tax system,
the taxable unit, raises the issue of whether the individual, the
couple or the family should be the taxable unit and whether a tax
on trusts and corporations should be retained. Under present in-
come tax laws, the taxable unit encompasses not only the individ-
ual, married couple and head-of-household, but such legal
entities as corporations, trusts and estates. By recognizing these
legal intermediaries while at the same time acknowledging that
only people pay taxes,118 traditional tax policy theory creates un-
certainty as to whether the proper taxpayer is being taxed.119

The uncertainty present in the taxation of the family is
whether the taxable unit should be the individual, the married
couple or family.120 Under the traditional approach, it is unclear
whether marital status alone should be determinative or whether
certain economic circumstances, such as the extent and effect of
pooling of income, economies of scale, dual consumption, and
imputed income and imputed cost of single earner as opposed to
two-earner couples, should be taken into account.121 One scholar
concluded that: "Lacking a better alternative, the federal tax sys-
tem uses marriage as a proxy to define economic units that derive
benefits from pooling financial resources to an extent that the tax

119. Traditional tax literature extensively researched the question of who
bears the incidence of the corporate tax but the answer goes unresolved. As
Joseph Pechman concludes: "There is no more controversial issue in taxation
than the question, who bears the corporation income tax? On this question,
economists . . . differ among themselves." This uncertainty taints the traditional
tax theorists' analysis of the impact of corporate tax on investment decisions,
resource allocation, debt financing and other issues. Federal tax jurisprudence
has, by and large, confined its responses to tinkering at the margins: assignment
of income, "S" corporations, rules of family partnership, clear reflection of in-
come doctrines, throwback provisions, grantor trust rules and the like. By rec-
ognizing these entities, tax policy theories debase the ability-to-pay concept. See
R. Goode, The Individual Income Tax 17 (Rev. ed. 1976); W. Vickrey,
Agenda for Progressive Taxation 278 (1947).
120. See Bittker, Federal Income Taxation and the Family, 27 Stan. L. Rev. 1389,
1391 (1975).
121. Traditional tax literature is full of analyses that taxpaying capacity is
best measured by consolidated marital and family income. See Coven, The Decline
system cannot ignore.”¹²²

Under the pragmatic approach, the taxable unit would be the family, and dependents would be taxed at their parents’ tax rates.¹²³ In addition, the trust as a separate legal intermediary would be eliminated.¹²⁴ Certainly, with a progressive tax system, more revenue can be generated by aggregating income into larger taxable units, such as the family. The incentive to engage in tax splitting devices could be curbed, thereby resulting in more efficient collection of revenue. Lastly, all these changes could be made without great practical difficulties.¹²⁵

The pragmatic approach would retain the corporation as a separate entity. It is simply not practical to collect tax on corporate income from the thousands or millions of persons who are shareholders. In addition, imposing tax liabilities from adjustments arising from audits of a business entity cannot be feasibly collected by assessments years later against a multitude of taxpayer shareholders.¹²⁶ Further, eliminating the corporate income tax would result in substantial loss of revenues because a large percentage of corporate shares are owned by pension trusts, other tax exempt entities and foreign investors that do not pay tax. As with the individual income tax, the corporate tax base would be broadened and the rates would be progressive.

D. The Gift and Estate Tax

The object of any taxing system is to fully utilize its taxing capacity. The income tax system does not fully utilize this capacity, however, because it is not practical to tax all accretion.¹²⁷ The


¹²⁴. For a discussion of trust reform proposals along this line, see generally Treasury I, supra note 101.

¹²⁵. Accord Thorson, supra note 122, at 925. Choosing the individual as the taxable unit would require separate accounting of the income of married couples. This has been considered such an administrative burden as to render impractical the use of the individual as the taxable unit.


¹²⁷. See Carpenter, Net Gift Given Rise to Taxable Income to Donor: Diedrich v. Commissioner of Internal Revenue, 24 B.C.L. Rev. 1429, 1431 nn.121-24
principal form of accretion that is not subject to income tax is the net accretion in the form of gifts and bequests. Consequently, there is a place in the federal taxing system for an estate and gift tax. The early gift and estate tax laws were intended to raise revenue.128 Later these purposes were replaced by equitable purposes—chiefly, to level accumulations of wealth. Under the pragmatic approach, the revenue purpose of the estate and gift tax would again become primary. Although the full taxing capacity of the state could be attained through a wealth tax on non-income earning assets such as paintings, cash balances, artwork, antiques or jewelry, such a tax would not be practical.129 While this type of wealth is more visible than capital income, it is not a feasible tax simply because of the valuation issues and the fact that there has never been such a national wealth tax.130

While it is true that over the years the estate and gift tax has not provided much revenue in relation to income taxes, the question should be not whether the estate and gift tax will provide much more or little more revenue when compared with other taxes, but whether gifts and estates constitute a source of revenue which is available to be tapped.131

Under a pragmatic approach, the present estate and gift tax would be modified. First, as with the income tax system, the base would be broadened. The estate should include property “substantially owned,” even though not actually owned, by the decedent.132 It should include all contractual or statutory survivor

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129. Such a tax could even be imposed on imputed income.
131. See, e.g., Gibbs, supra note 128, at 811. Gibbs remarks that the gift tax laws were never intended to produce revenue from those who economically fall within the lower to middle classes. Id. Even so, in inflationary periods, the revenue producing potential of the estate tax swells as the size of the middle class estate comes within much of the federal tax. Id. (citing Friedman, The Law of Succession in Social Perspectives, in Death, Taxes and Family Property 21 (E. Halbach ed. 1977)). He further notes that the federal estate tax yielded $4.6 billion in 1975, equivalent to 1.7% of total federal tax receipts. Id. (citing Tetscher, The Aims of Death Taxation, in Death, Taxes and Family Property 41 (E. Halbach ed. 1977)).
132. Generally, the courts have rejected the Service’s relatively rare attempts to impose an estate tax under § 2033 where the decedent’s rights in property are less than actual ownership. See Helvering v. Safe Deposit Trust Co., 316 U.S. 56 (1940); Estate of Tully v. United States, 528 F.2d 1041 (Ct.Cl.
benefits economically attributable to the decedent. Such benefits that accrue to the surviving family member should be included as well as benefits receivable by the executor. Examples are Social Security death benefits and copyright renewal or termination rights. The taxable estate should also include the lapse of the so-called "five and five" powers. Life insurance, even if there are no incidents of ownership held by the decedent, should also be part of the taxable estate as long as the decedent made the premium payment. Lastly, the gift tax should be "gроссed up" and included in the taxable estate of the decedent when the decedent made gifts during his life that resulted in a gift tax.

Second, the estate and gift tax system should be revised to limit the gift tax exclusions and the unified credit. The present per-donee gift tax exclusion has led to complex rules and to widespread tax avoidance, particularly in the use of so-called Crummey trusts. Moreover, the current level of the per-donee exclusion permits large-scale escape from transfer tax for a donor with many descendants or other donees. The tax system under the pragmatic approach would limit the amount of the tax exclusion to a certain amount per donor. Similarly, under the pragmatic approach, the unified credit would be limited. Under present law, with proper estate tax planning, a married couple can die with $1.2 million and pay no estate tax. This would be reduced under the pragmatic system so that more decedents' estates pay

1976); Estate of Porter v. Commissioner, 442 F.2d 915 (1st Cir. 1971); Kramer v. United States, 406 F.2d 1363 (Ct.Cl. 1969); Estate of Wadewitz v. Commissioner, 39 T.C. 925 (1963), aff'd on other grounds, 339 F.2d 980 (7th Cir. 1964); Hinze v. United States, 72-1 U.S.T.C. ¶ 12, 842 (C.D. Calif. 1972); Estate of Royce v. Commissioner, 46 B.T.A. 1090 (1942); Estate of Sessions v. Commissioner, 8 T.C.M. (CCH) 1056 (1949). This change would merely coordinate the income tax provisions with the estate tax provisions. See Helvering v. Clifford, 309 U.S. 331 (1940); I.R.C. § 61 (West Supp. 1986).

133. This would overrule previous decisions of the federal courts in Estate of Kramer v. United States, 406 F.2d 1363 (Ct. Cl. 1969); Estate of Fusz v. Commissioner, 46 T.C. 214 (1966). These rules would apply to community property, awards on divorce or separation, and rights created by the Retirement Equity Act of 1984.


135. Under the Code, the gross estate includes only those amounts "with respect to which the decedent possesses at his death any incidents of ownership, exercisable either alone or in conjunction with any other person." I.R.C. § 2042 (West Supp. 1986).


137. See Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968).

138. I.R.C. § 2010 (West Supp. 1986) (unified credit against estate tax); id. § 2505 (unified credit against gift tax).
taxes. In addition to changes in the amounts exempt from estate and gift tax, the estates would become more progressive under a pragmatic approach. These changes would aim, as with the income tax, not at levelling of wealth, but the collection of more revenue. The smaller the exemptions and the higher the rates, the more revenue is collected. As in the income tax area, the questions are how much should be exempt and how progressive should the rates be as determined by a calculus of utility.

V. THE CALCULUS OF UTILITY

A useful tax policy must be refined to the point where it can guide decisionmaking on an operational level. On that level the tax system is not some monolithic manifestation of broad principles. Rather, it is a multitude of individual provisions that in the aggregate determine how comprehensive or burdensome the income tax will be. This is the greatest failure of the theoretical approach and where lies the greatest need for a pragmatic approach.

Traditional tax policy literature uses certain assumptions about the behavior of individuals and the economy under an "equitable" and "efficient" tax system. In general, equity-oriented theorists usually assume that the taxpayer continue to behave the way they would without the change in the system, or that the change in economic conduct does not significantly alter the pre-tax yield produced by the change. Efficiency-oriented theorists, on the other hand, presume the taxpayer will act to save taxes by taking advantage of the change in the system. The problem with traditional tax policy theory is that it does not use empirical data to determine the actual effect of the change on the taxpayer and the economy. As Boris Bittker observed:

It is hard to see how the normative standards favored by either equity or efficiency theories can be applied with confidence to existing law while the behavioral consequences of most tax allowances remain terra incognita. Only when they are mapped will we be able to say with assurance whether particular tax allowances generate inequities, misallocations, or some of each. Until then, intuition and political preferences must be the basis for analysis because scholars, alas, can legitimately claim lit-

tle more authority than the average citizen.\textsuperscript{140}

The unstated premise of all tax policy is that a tax system can be intelligently designed, implemented, and administered, but this requires goals and means of measuring whether the goals have been met.\textsuperscript{141} Otherwise, there can be no nexus between tax policy and applied taxation. This is one reason a theoretical tax policy is ineffective; there is simply no way to measure the performance of the tax system in terms of theoretical goals. Just how well the performance of the tax system can be measured is clearly open to debate, but unquestionably, the performance of the tax system can be empirically measured both directly through measurements of the tax base, tax rates, rate of compliance and costs of administration, for example, and indirectly through other criteria of a purely economic nature, such as GNP, rate of inflation, capital investments, savings, etc.\textsuperscript{142} Thus, these "empirical criteria", because they are the only measures of applied taxation, are the only "tools" available with which to evaluate and shape the tax system. Accordingly, the goals of tax policy must be framed in terms of empirical criteria. By monitoring such empirical criteria while adjusting the tax system, the relative performance of alternative tax schemes could be measured and the tax system could be verifiably improved.

This suggests how tax policy might be put into practice, but it still does not answer the question of how to set the objective goals of tax policy, without which the empirical measures of performance would be meaningless. In order to develop a coherent tax policy, which is necessary in order to make tax policy normative, the objective goals of tax policy must be refined from the two fundamental rules of taxation. If the purpose of the tax system is to raise revenue, the objective of tax policy must be to maximize the utility of the tax system, but there are practical limits to the bur-

\textsuperscript{140} Id.
\textsuperscript{141} Id. at 748.
den that can be placed on a tax base. This means that if there is a predetermined tax base, tax policy should have as its goal the maximization of revenue within the limits of the base's taxable capacity; or if there is a specific revenue requirement (which in practice would always be the case), tax policy should try to extract that amount of revenue from the available tax base with the least impact. In other words, instead of seven general criteria and uncountable specific criteria entering into each decision, all tax policy would be made on the basis of the efficient collection of revenue.

While this may appear to be simply another description of an "ideal tax," this formulation actually states a coherent, albeit complex, calculus. Because the objective of tax policy is to maximize the utility of the tax system, the only adverse effects of taxation that tax policy can legitimately be concerned with are those that redound to the tax system itself. Consequently, the degree of normative guidance that can be achieved by taking a pragmatic approach to tax policy will depend upon how precisely efficiency can be quantified in terms of the "empirical criteria" that meaningfully relate to tax system performance. Exactly what variables would enter into such a "calculus of utility" would have to be worked out experientially, but essentially it means that decisions of tax policy should be made according to how they affect the rates, tax base, taxable unit and cost of administering the tax system.  

Such a proposal plainly invites two questions: 1) Is a calculus of utility theoretically possible? and 2) Is a tax system based on a calculus of utility politically possible? In answer to the first question, the integration of a calculus of utility would unquestionably be complex. And of course it could never be integrated to the point where a formula would mechanically yield the definitive tax base, rate structure and coefficient of administration cost-effectiveness. Nevertheless, the relationship of and between those variables and the empirical criteria by which the performance of the tax system can be measured is real. Therefore, such a calculus should be theoretically possible.

143. These factors affect the direct measurement. For example, when capital investment and GNP increase, so does the tax base. The purely economic indirect measurements, would also be important, because they affect the efficient collection of revenue.

144. Equilibrium simulation models have recently been used for empirical research into the efficiency cost of taxes and changes on the tax structure, such as raising the marginal tax rates. See Gravelle, NON-NEUTRAL TAXATION OF DEPRECIATING ASSETS: THEORY AND EMPIRICAL APPLICATION TO THE UNITED STATES, 189 (1981) (NIA-TIA, Proceedings of the Seventy-Fourth Annual Con-
Evidence that such a calculus is possible is found in the "Laffer curve," itself a rudimentary calculus of utility. Basically, the "Laffer curve" is an economic graph (derived from historical analysis) which suggests there are two tax rates (between zero and one hundred percent) which will produce the same amount of revenue from a given economy: a high rate, which is regressive and thus retards economic growth, thereby impacting the tax base and thus, total revenue; and a lower rate, which is correspondingly less regressive and thus allows greater growth, which in turn results in a larger base, which compensates for the reduced tax rate. The parameters of the Laffer curve have never been quantified, and it has been harshly criticized for being overly simplistic. Nevertheless, its significance should not be overlooked. That such a curve has normative implications is plain—an efficient tax system should tax at the lower rate. In spite of its simplicity, the Laffer Curve has been described as a powerful analytical tool with great political relevance, which is hard to refute since it has already had a significant impact on federal tax policy. Thus, the Laffer Curve illustrates both the nature and the potential of a calculus of utility.

While a pragmatic tax policy based on how decisions affect the tax rates, tax base, taxable unit and cost of administration might be criticized as appearing to be politically unfeasible because of its narrow scope, this criticism would be unwarranted because it is far from narrow. A calculus relating those variables would be sensitive to both public reaction and macro-economics, in short, to the whole political-economic environment in which it must operate. But before discussing "feasibility," the issue of "total revenue" should be briefly addressed.

Notably, and perhaps surprisingly, total revenue is not a part of the tax policy calculus that must be balanced. The total revenue goal is set as a matter of fiscal policy and then is imposed on the tax system as a constant. Of course, tax policy considerations go into the fiscal policy equation with respect to setting the revenue-debt ratio of financing total expenditures, and thus they in-

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fluence what the total revenue target will be. But the revenue target is not per se an element of tax policy. Hence, total revenue is only a factor in developing tax policy insofar as tax policy must juggle the tax rates, tax base and administrative costs to efficiently raise the prescribed revenue.

But is a pragmatic tax policy politically feasible? In other words, would it make good political sense, which is not to ask, will it actually be implemented? Although it is beyond the scope of this paper to try to refine a calculus of utility and apply it, the shape of a pragmatic tax policy and the resultant tax system should nevertheless be evident. The major change obviously would be that the tax system would no longer serve as a vehicle for social and economic policies unrelated to the administration of the system itself, which is not as politically radical a proposal as it might appear.

VI. Conclusion

The federal income tax system is currently under attack from all quarters. Its inadequacies are manifold. But the tax system merely reflects tax policy; tax policy itself, in the aggregate, is inarticulable and theoretically incoherent. The general belief is that the tax system, and thus, tax policy, needs comprehensive and radical reform. But topical tax policy and tax system reforms have been tried over and over without success. In the past, it seems that for each step forward, tax reform has taken two steps backwards. What is needed, therefore, is reform that can break the pattern of failure.

The thesis presented in this paper asserts that past attempts at reform have failed because the classic "theoretical" approach to taxation yields theoretical criteria of income tax policy that can never be normative in any meaningful sense. Accordingly, the theoretical approach must be abandoned and a "pragmatic" approach must be adopted. Essentially, a pragmatic approach sim-

146. The focus of this paper is on administrative rather than political feasibility. It is the author's view that except for the elimination of the charitable and mortgage home deductions and the inclusion of life insurance proceeds in the gross estate of the decedent, the tax system proposed is politically feasible.

147. The strongest argument that a pragmatic tax policy is politically feasible exists in the Tax Reform Act of 1986. The underlying philosophy of the Act contained therein is patently pragmatic. Its purpose is to eliminate, to a greater or lesser extent, special tax policies in order to broaden the tax base and reduce tax rates, all with an aim to increase the economic and administrative efficiency of the tax system. See generally Tax Reform Act of 1986, Pub. L. No. 99-514, § 601(a), 1986 U.S. CODE CONG. & AD. NEWS (100 Stat.).
plifies tax policy by restricting it to considerations of efficient revenue raising. In designing a successful tax system, this is more objective than the other criteria that have heretofore influenced tax policy, so there is no reason to consider others. Through a pragmatic approach, tax specialists can develop a “calculus of utility” around “empirical criteria” related to tax system performance. However, a calculus of utility and empirical criteria are no more the stones by which philosophers magically reveal the definitive tax structure than were theoretical criteria. Because the economy is dynamic, so must the tax system be dynamic as well. But together, a calculus of utility and empirical criteria forge a nexus between policy and practice, and thus are the tools of a pragmatic tax policy by which the tax system can be intelligently and successfully reformed.