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SIMPLIFICATION AS A TAX POLICY OBJECTIVE

H. STEWART DUNN, JR.

As we enter into the decade of the 1980's, with a new Administration and with major changes in the personnel, organization and leadership of the Congress, this is a logical and timely moment to review and evaluate the ongoing efforts to simplify the federal tax laws. Simplification of our tax laws has itself become one of the tax policies that shapes legislative and administrative programs. Before we can consider the role of simplification as a tax policy for the 1980's, we need to consider what we mean by tax simplification, what are the principal factors that have led to complexity, and what are the accomplishments to date in the battle.

In any study of the policy objectives of tax simplification, one immediately confronts the questions: What is simplification; and what is complexity, if complexity is the opposite of simplification in our federal tax laws? There are certainly no agreed definitions for these terms in the federal tax system. In fact, many of the most learned persons who have devoted time and attention to the important subject of tax simplification as a policy objective have concluded that the consideration and analysis is obscured by using the terms "simplification" and "complexity." Nevertheless, these are the terms in which the discussion is framed and therefore some consideration of the meaning of these terms or of any acceptable alternative for them is necessary before proceeding into the subject.

For persons experienced in the United States federal tax system, the effort to define simplification may best fit within the cliche, "I may not know how to define it, but I certainly know it when I see it." The difficulty with any such approach is that what one person sees as simplification under such a visceral judgment may well be viewed as complexity by another. Therefore, let us consider a few of the factors that are frequently cited in determining whether tax legislation is simplifying. First, and often most significantly for those who are initially considering this subject, is the mere length of the federal tax laws. When the first federal tax legislation was enacted by Congress during the Civil War, the length of the entire law covered two pages. Today, the full Internal Revenue Code consists of thousands of pages and in most versions requires a volume of telephone book thickness even when printed without footnotes or legislative revisions information. Even experienced tax experts are dismayed and at times overwhelmed by the complexity of many of the provisions of the Code. Critics of this form of complexity have numerous illustrations, such as a single sentence from one subsection of the Code which is longer than the

2 The Internal Revenue Code is Title 26 of the United States Code, and in the annotated version encompasses 16 volumes.
entire Gettysburg Address of President Lincoln. Tax law is not limited to the Congressional enactments but includes volumes of regulations, court decisions, and numerous pronouncements and publications from the Internal Revenue Service and other offices of the Treasury Department. While the bulk of this material is enormous, volume or bulk is not necessarily complexity and the elimination of it is not necessarily simplification. The Installment Sales Revision Act of 1980, and as has been shown by other pieces of legislation, legislation, albeit lengthy, which resolves previously disputed or transactionally complicated areas of the tax law makes a significant contribution towards tax simplification.

One must get beyond weighing mere length or bulk in evaluating simplification. More subtle factors have to be considered. These include whether the complexity applies to a large number of taxpayers or only to a relatively small number of taxpayers, and whether the taxpayers affected can reasonably afford the cost of expert advice in analyzing and complying with such complexity. In this situation, as in many others, appearances are deceiving. What appears to be a reasonably simple proposal may, in fact, generate a “dynamic complexity.” It is important to understand and appreciate the role of dynamic complexity. Taxpayers may be motivated to make investments or take other actions that are motivated by such a tax provision. In some cases, this will be intended, such as various provisions to stimulate charitable giving, home ownership, and innumerable other tax incentives. But even these produce counter-reactions which are often extremely complicating, such as limitations on charitable and interest deductions, and the minimum tax and the alternative minimum tax. In other cases, it will be an unintended result, such as the whole development of shelter programs in response to high rates of taxation and the differential between ordinary income and capital gains rates. In either event, difficult compliance problems will be presented for the tax administrator and complex financial transactions will be generated that would not be attractive but for these provisions of the tax law. As illustrated, dynamic complexity has the important characteristic of evoking further legislation from the Congress which in turn evokes further tax planning and financial transactions by taxpayers. The history of tax shelters over the last twenty years is a prime example of this dynamic complexity.

When one sorts through these various factors in trying to define simplification or complexity, it becomes reasonably clear that the policy in advocating a movement toward simplification of our tax laws is basically one to bring certainty into the tax law and to bring it on terms and costs that are reasonable to the parties involved. This point is effectively made by Sidney Roberts in his article in the Tax Law Review in which he states,

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8 See section 341 (e)(1).
5 Numerous examples may be cited, although none is entirely free from controversy regarding its contribution to simplification; but see, e.g., sections 82 and 83.
To the tax lawyer, complexity means (1) a reasonably certain conclusion in some instances cannot be determined despite diligent and expert research, (2) a reasonably certain conclusion can be determined in other instances only after an expenditure that is excessive in time and dollars.

Looked at from the other side, Mr. Roberts and others are saying that the goal is to have a tax law which the taxpayers can understand and with which they can comply at a cost that is commensurate with their financial circumstances and the particular transactions involving them. I subscribe to this same view that what we are principally seeking is certainty, but I would go a little beyond Mr. Roberts and some others. Simplification should mean not only certainty but also stability. Proposals that initially appear to be simplifying will not really produce simplification if they generate dynamic complexity.

Having briefly considered what we mean by tax simplification and complexity, it is worthwhile to list and to comment briefly on the principal factors that have created this enormous complexity in our tax laws. In my judgment, the principal causes include the following:

1. The American society and economy is a large and complex one. There are millions of taxpayers who operate through a variety of different forms and organizations. There are an innumerable number and variety of financial transactions that have to be considered in structuring our federal tax laws. This factor alone assures that we will never return to the policies and simplicity of the two-page Civil War income tax law.

2. While it may distress some, there seems to be little doubt that a major cause of complexity in our tax laws is the goal of equity. As a generality, it can be said that equity and simplicity are at war with each other. A simple provision is almost never equitable, and an equitable provision is almost never simple.

3. Another major cause of complexity is the need or desire to accomplish non-revenue raising goals through our federal tax laws. If one could start with the premise that the only significant function of the federal tax law is to raise a given amount of revenue, one could make enormous moves toward simplification very quickly. Practically all of the exclusions, deductions and credits which are the principal cause of complexity in the tax laws were added for the purpose of producing some result unrelated to the raising of revenue.

4. I believe that a further factor is that we have here in the United States a federal government of separate powers rather than a parliamentary system. In parliamentary democracies, the government introduces tax legislation and, with minor exceptions, this legislation is either enacted as introduced or the governing party

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6 A review of the Code will demonstrate that well over half of the provisions of Subtitle A could be eliminated if the only goal of Subtitle A were to raise revenue.
may be required to call for new elections. In our system of powers, there is frequently little relationship between the legislation proposed by Treasury, as spokesman for the President, and the legislation ultimately enacted by the Congress. Thus, our tax legislation is invariably the final condensation of compromises among competing forces including the Treasury, the House of Representatives, the Senate, its tax-writing committees, and the various tax-paying groups which are affected by the legislation. To compromise these competing interests, our legislation contains exceptions to the exceptions to the exceptions. While it may be argued that this produces superior tax legislation to that produced under the parliamentary system, it does not produce simpler legislation.

5. There are in our society a number of groups with a vested interest in complexity. This should be distinguished from groups that have an interest in having tax legislation which is favorable to them. Of course, as stated in paragraph 4 above, lobbying groups espousing various economic, social or fiscal goals do add to complexity. Here, I am referring, however, to special groups who are directly benefited by complexity. It is frequently noted that lawyers and accountants, especially those specializing in federal tax matters, fall into this category. There is probably some truth in this accusation, but it is also true that these same professional groups have been the leaders in seeking tax simplification. More culpable are the numerous businesses that have developed to promote and expand tax shelters. These businesses which, in the aggregate, have become a significant industry, are almost solely dependent upon tax complexity and high individual tax rates for their success.

These factors and certain others have produced a dramatic growth in the complexity of our tax laws over a period which might be dated from at least the end of World War II to the present time. This growth has now reached what in the opinion of many is epidemic proportions. The percentage of persons who prepare their own returns has now increased to approximately fifty percent. Even the ability of tax experts to understand and then to advise their clients is in jeopardy due

7 See, e.g., section 170 and 341.
8 Various major tax bills since 1909 have been described by wags and wits as "The Attorney's and Accountant's Relief Act."
9 See text accompanying note 14 infra for discussion of efforts of bar and accounting groups on behalf of the simplification movement.
10 Issues In Simplification of the Income Tax Laws, A Report prepared by the Staff of the Joint Committee on Taxation; submitted to the Committee on Ways and Means, U.S. House of Representatives, and the Committee on Finance, United States Senate, pursuant to Section 507 of Public Law 94-455 (Sept. 19, 1977). This report contains much useful data and information, and should be studied by any person interested in this subject. Its footnotes are also an excellent bibliography of authorities and articles in this field.
to this perceived growing complexity.\textsuperscript{11} Of equal importance, the Internal Revenue Service is finding it more and more difficult to effectively administer the federal tax laws pouring forth from Congress. The growing awareness at all levels of our society of the complications in our tax laws and the resulting cost, confusion and non-compliance have led to a broad and generalized enthusiasm for the simplification of federal tax laws. Simplification of the tax laws has almost reached the level of God, country, motherhood and apple pie among subjects that are generally revered and supported by all sectors of our society. With the complexity of our tax laws having been labeled as “the cause of a taxpayers’ revolt,” numerous forces have taken on the cause of simplifying the tax laws, all with good intentions and some with good, but modest, result. A brief review of these endeavors is useful as a background in our discussion of simplification as a tax problem.

Over the years in which we have had federal income tax, periodic concerns have been expressed about complexity of the tax laws.\textsuperscript{12} But the sharply increasing concern with simplification that interests us focuses on developments in the 1970’s and through the current year. In 1972, the New York State Bar Association published its report, “A Report on Complexity and Income Tax.”\textsuperscript{13} This excellent study concluded with a recommendation that a federal commission be established, with a full-time staff, to undertake a long-term study of tax simplification. The New York State Bar group anticipated that the commission report would be the subject of legislative action in the Congress. At about the same time that the New York State Bar Association was preparing and publishing its report on tax simplification, the Tax Section of the American Bar Association established its Special Committee on Simplification. This Committee has served as the Tax Section’s, and also the American Bar Association’s, catalyst for federal tax simplification. Its contributions can be seen in connection with various other developments discussed below.

A particularly useful development in the movement to encourage simplification of the tax laws was the conference jointly sponsored by the American Bar Association and American Law Institute at Airlie House on January 4 through January 7, 1978. At this conference, a number of papers were submitted by eminent lawyers and legal scholars on a wide range of subjects related to simplification of our tax laws.\textsuperscript{14} Anyone seriously interested in simplification as a tax policy, or in simplification in specific areas of tax law, will certainly want to examine the papers presented at this Airlie House conference. The

\textsuperscript{11}Id. at 17.
\textsuperscript{13}Committee on Tax Policy (1970-71), New York State Bar Association, Tax Section, 27 Tax L. Rev. 325 (1972).
\textsuperscript{14}\textit{Federal Income Tax Simplification}, with an introduction by Charles H. Gustafson, a Joint Project of the American Law Institute, the Section of Taxation of the American Bar Association, and the American Law Institute-American Bar Association Committee on Continuing Legal Education (1979).
Airlie House conference, which was itself stimulated by the Tax Section's Committee on Simplification, by Hugh Calkins of Cleveland, who represented both the Tax Section and the American Law Institute, led to a number of other developments in the simplification movement. Under Mr. Calkins' leadership, several regional conferences were organized, and it is reasonable to assume that the more recent governmental actions to advance tax simplifications were encouraged, if not fostered, by ideas developed in this Airlie House conference.

Thus, the bar associations have played a key role in the decade of the 1970's in initiating and fostering programs for simplification of the federal tax laws. It is the legislative and executive branches of the federal government, however, that are responsible for implementing federal tax policies and, consequently, any movement towards tax simplification is only significant to the extent that it is supported and ultimately adopted by these branches of government.

While it has long been a statutory function of the Joint Committee on Taxation to investigate methods for simplification of tax laws and to publish proposals to this effect, this function had not been directly pursued by the Joint Committee. However, in the Tax Reform Act of 1976, Congress expressly called upon the Joint Committee to conduct a study on "Simplification and Indexing of the Tax Laws" (including whether tax rates can be reduced by repealing any or all tax deductions, exemptions or credits). In response to this legislative initiative, the Staff of the Joint Committee submitted a detailed report to the Senate Finance and House Ways and Means Committee. The Subcommittee on Oversight of the Committee on Ways and Means held hearings on tax simplification, particularly as related to the President's then pending tax proposals. These hearings were held on March 21, 1978 and resulted in a series of reports from the Committee. While these various reports from the tax-writing committees have been helpful encouragements in the tax simplification struggle, by far the most important and most practical development has been the establishment of a procedure whereby legislation to simplify the federal tax laws can receive Congressional review and finally enactment. A key subcommittee in the Ways and Means Committee and a key subcommittee in the Finance Committee have been assigned this responsibility and their respective Chairmen have taken on this assignment with interest and dedication. I refer to the work of the Subcommittee on Select Revenue Measures of the House Ways and Means

15 Section 8022(2)(3).
17 See note 10 supra.
While the legislative branch has been stirring in the areas described above, the Treasury Department and the Internal Revenue Service have also shown a growing interest in the tax simplification movement. By far the most important development from the Executive Branch was the publication of Blueprints For Basic Tax Reform by the Treasury Department on January 17, 1977. It is the only federal government study that has considered basic tax reform with emphasis on simplification and has proposed major alternative programs for such a basic tax reform and simplification program. This publication, in turn, led the Committee on Simplification of the Tax Section of the American Bar Association to undertake a detailed analysis and presentation of the simplification aspects of basic tax reform.

In Blueprints For Basic Tax Reform, the Treasury sets forth in considerable detail two fundamental alternatives for reform, each of which could produce a considerable amount of simplification in our tax laws. The first is a broad-based income tax which would enable the same amount of revenue to be raised by eliminating many or most exclusions, deductions and credits and reducing rates dramatically. The second alternative is for

19 Dan Rostenkowski (D., Ill.), Chairman; now the new Chairman of the Ways and Means Committee.
20 Harry F. Byrd, Jr. (I., Va.), Chairman.
23 Blueprints For Basic Tax Reform, Department of the Treasury (January 17, 1977), GPO Stock No. 048-004-01390-8.
24 Evaluation of the Proposed Model Comprehensive Income Tax, Special Committee on Simplification, Section of Taxation, American Bar Association, 32 Tax Lawyer 53 (1979).
25 Under the Model Comprehensive Income Tax, the same amount of revenue could be raised at rates for joint returns as follows:

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $4,600</td>
<td>8%</td>
</tr>
<tr>
<td>$4,600 - $40,000</td>
<td>25%</td>
</tr>
<tr>
<td>Over $40,000</td>
<td>38%</td>
</tr>
</tbody>
</table>

Several alternatives are presented depending on the scope of the base, filing unit, etc. Blueprints For Basic Tax Reform, supra, Chapter 3 and Chapter 5, pp. 159-167.
a consumption tax which substitutes a tax on consumption for a tax on income. The studies of the Committee on Simplification with respect to Blueprints relate only to the broad-base income tax, but these studies are particularly significant to us because they deal predominantly with the simplification aspects of this program.

The Internal Revenue Service also has shown an increasing awareness of the problems of complexity and has stressed this through its effort to make tax returns clearer and more easily understood, certainly a most direct and useful approach to the problem.

It is important to mention the work of the Staff of the Joint Committee on Taxation, which includes the preparation of the report under section 507 of the Revenue Act of 1976, the work on the Installment Sales Bill, and the ongoing proposals which are discussed below. Also important is the work done by the General Accounting Office in its ongoing studies of specific subjects, with particular emphasis on those which are viewed as the most common tax problems of individual taxpayers.

In looking into the immediate future, it is encouraging to note that the forces which produced the Installment Sales Revision Act of 1980 are beginning to move on a number of other subjects which are useful areas for tax reform. These forces include the Rostenkowski Committee, the Byrd Committee, the Treasury Department, the Staff of the Joint Committee on Taxation, the Simplification Committee of the American Bar Association, the AICPA's and various bar groups, particularly those from the State and City of New York. The principal simplification proposals which are now under active consideration are as follows:

1. A revision of subchapter S.
2. Reversal of the Supreme Court's decision in United States v. Davis. In this case, the Supreme Court held that the exchange of property for release of marital rights is a taxable event. In light of the experiences in the installment sales legislation, it is useful to review this proposal on the repeal of the Davis case to illustrate that matters are never as simple as they may initially appear. The Davis case has undoubtedly complicated the tax problems for separating and divorcing spouses. It creates difficult questions of what are marital rights as opposed to support or alimony payments. The decision has caused a great deal of complex and often unsound planning and has generated considerable litigation. Nevertheless, a proposal to reverse the Davis case introduces problems and complexities comparable to those which were experienced in the installment sales legislation. For example, if Davis were repeated, how would pre-divorce trans-

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26 See note 24 supra.
27 See note 10 supra.
28 Dring, Subchapter S Recommendations by the Joint Committee, in this book.
fers be treated? Under section 2516, a divorce must occur within two years of a property settlement to avoid gift tax liability of property transfers incident to the settlement. Should a similar time period be adopted in the Davis case? Should a special rule apply when the separation is entered into in lieu of a divorce decree? Should a similar time period be adopted in a repeal of Davis rules? Should such a rule apply when a decree of separation is entered in lieu of a divorce decree?

If Davis rules were repealed, some provision for a carryover basis would be required. Should each piece of property retain its pre-transfer basis, as in Rev. Rul. 76-83? Should basis be pooled and divided among assets subject to transfer or division by a court, includable in a settlement, or actually included in a settlement?

If Davis were repealed, should a change be made in the tax treatment of long-term payments under section 71(c)(2)? Should payments extending for a period of more than ten years be treated as alimony, even though in exchange for property rights?

If Davis rules were repealed, what conforming changes, if any, would be required in estate and gift tax provisions? If death were to occur after the transfer and before the divorce, should the exclusion from Davis rules apply?

In some cases should Davis rules be optional, viz.; should spouses have an option to elect tax-free or taxable treatment, for example, when sections 121 or 1034 would apply? If so, should the spouses be required to make a joint affirmative election of taxable treatment?

What conforming changes, if any, would be needed in the tax treatment of alimony trusts?

Should a definition of "marital rights" be established and tax-free exchanges limited to cases in which such rights are released? Should the repeal exclude transfers which, in essence, are exchanges of property or property rights for cash? Should property transfers be treated differently if a sale of the property would produce ordinary income to the transferor spouse and capital gain to the transferee spouse?

I believe that a mere listing of some of the problems that have to be considered and resolved in reversing the Davis case effectively illustrate the difficulties in simplifying the tax law through remedial legislation even when the area under consideration is relatively narrow and there is a general consensus about the desirability of the change.

3. A somewhat related question to the repeal of the Davis case is the allocation of the personal exemption under section 152(e) between separated or divorced parents. The Committee on Simplification of the Tax Section of the American Bar Association

30 1976-1 C.B. 213.
has recommended a revision of section 152(e). This would replace the rather complex and elaborate factual test of section 152(e) in determining who is entitled to an exemption for children of divorced and separated parents. Furthermore, section 152(e) does not resolve all cases with respect to this issue. Under this proposal of the Committee on Simplification the exemption would be awarded in the following priority:

a. In accordance with any agreement reached between the parties. This would be without regard to support or custody.

b. In absence of an agreement to the parent or other person who has custody of a child for more than half the days of the taxable year (or perhaps more than 60% of the days of the year).

c. If neither of the above is applicable, the exemption will be divided equally between the parents. This would entirely eliminate the support test with its very difficult factual problems and would provide certainty. The divorcing or separating parents would be able to plan their agreement in the light of this certainly.

4. Other matters relating to separated or divorced parents or surviving parents also are under consideration in this process. These include modifying the ten-year period for installment payments of alimony, a uniform definition of an unmarried individual, and a revised definition for head of household family or even possibly the elimination or consolidation of head of household family status.

   It is the general opinion of those concerned that these tax issues of divorcing or separating parents and of surviving parents lend themselves particularly well to legislative revisions to simplify the tax rules governing these situations. Present rules have spawned a great deal of uncertainty, mischief and litigation. It is also understood that this area has been one of the areas generating the greatest number of malpractice claims by clients against their counsel. Furthermore, this may be an area in which there are not great policy issues or political pressure that conflict with the simplification goals.

5. Another and different area under consideration for legislation to simplify the law is a proposal to merge section 6166 and section 6166A. These are provisions that allow extension of the time for paying estate taxes where the assets of the estate consist largely of interests in closely held businesses. Associated with this proposal to merge section 6166 and section 6166A is a proposal to integrate these combined sections with section 303 which deals with the redemption of stock of a closely held business for the purpose of paying estate tax. Again, this proposal which seems clearly laudable generates a number of technical

31 Blueprints For Basic Tax Reform, supra note 23.
problems. Also associated with this project is a study to simplify the results produced by the Tax Court's decision in Estate of Bahr.\textsuperscript{32}

6. A revision of section 1033 to allow reinvestment in property of like kind under the standards of section 1031, rather than the more limited present standards of section 1033 which requires an investment in property similar or related in service or use to the property so converted. This has already been partially accomplished by section 1033(g) dealing with reinvestment of real estate.

7. A revision of section 246 dealing with the dividend received deduction to eliminate the restriction on the deduction to a certain amount of taxable income. This is a modest proposal and almost might be viewed as more of a "deadwood" proposal.

8. To increase the list of defined terms under section 7701. This project would have a two-fold purpose. First, to bring into section 7701 various terms that are defined differently in various provisions of the Code. For example, the term "timely filed" might lend itself to a uniform definition. Of course, this is potentially a very broad subject since it could lead to such things as uniform attribution rules, but it is doubtful that it would reach this scope. A second area of endeavor here would be to introduce in section 7701 terms that are not presently defined in the Code, but which do raise uncertainties and cause confusion for both taxpayers and tax administrators.

9. Consideration is being given to proposals to modify section 267(a)(2) so as to either conform the two-half month rule of that provision with the present three-half month filing period for individuals, or to revise section 267(a)(2) to avoid a total loss of payor's deduction by allowing the deduction in the year in which it must be included in the gross income of the payee.

10. To resolve the problems of technical noncompliance under the charitable remainder trust rules. Congress is in the process of again extending the period of time for such resolutions until December 31, 1981.\textsuperscript{33} Nevertheless, at some point the problem has to be addressed on the merits and this could be a proposal to be included in any forthcoming simplification legislative package.

We should now step back and review what I have been discussing and turn to the issue of simplification as a tax policy. We have looked back in history, at least at the history of this past decade, and have noted the growing awareness and concern about the complexity of our tax laws. I have sought to describe what I believe are the principal factors that produced this complexity in our tax laws. I have sought to outline the principal government and nongovernmental responses

\textsuperscript{32} Bahr v. C.I.R., 119 F.2d 371, 27 AFTR 121 (5th Cir. 1941).

\textsuperscript{33} Miscellaneous Revenue Act of 1980, 96th Cong. 2d Sess., P.L. 96-605.
to this growing concern about the complexities of our federal tax laws. A related paper by Mr. Lerner on the Installment Sales Revision Act of 1980 explains the most significant specific result today of this battle against complexity. Now we must turn to the principal issue of my paper, which is, what is the role of simplification as a tax policy objective. As I stated earlier in general terms, "simplification" of our tax laws has joined God, country, motherhood and apple pie as a shibboleth supported by all. Without commenting on the fundamental strength of the support for God, country and motherhood, or even apple pie, I am gravely concerned that the support for tax simplification is only superficial. It is certainly not that those who support simplification of the tax law are being disingenuous, but rather that other goals, which are viewed as more important, override the simplification goal in the realities of the legislative and even the administrative process. Accomplishment of significant tax simplification requires legislative action. While much can be done by the Internal Revenue Service administratively with the help and cooperation of the bar, accountants and other professional groups, any basic changes must come through the legislative process. Under the legislative process, there are two fundamental approaches. The first approach, which is best presented by the Treasury's Blueprints for Basic Tax Reform, would involve a major revision of our revenue laws. This could take the approach of replacing the federal income tax law with an alternative revenue raiser. These alternatives include the value-added tax, a national sales tax, and a consumption or expenditure tax. If the federal income tax were replaced by one of these alternatives, we would have a marvelous opportunity to bring major simplicity into the taxing system. However, as has been demonstrated by looking at some specific proposals in the federal income tax system, the simplicity produced would be far less than that which might be initially anticipated. The Committee on Simplification is about to publish a paper examining the simplification aspects of a consumption tax, and I recommend this to anyone who is interested in a sobering evaluation of the simplification prospects of moving form an income tax to one of these three principal alternatives. More significantly, whatever might be the potential simplification benefits of such an entirely new alternative, it seems that there is no likely prospect within the foreseeable future that the federal income tax system will be repealed and replaced by one of these three alternatives. Certainly, some serious interest in the value-added tax was generated and strong support for it was expressed by both the then Chairman of the Ways and Means Committee and Chairman of the Senate Finance Committee. However, this did not meet with any broad support either in Congress or outside of Congress. The political defeat of Mr. Ullman will probably discourage members of Congress from supporting such alternatives for many years to come. Even this past support, which has now greatly waned, was not to replace the

34 See note 23 supra.
federal income tax with the value-added tax, but to have it in addition to the federal income tax law. It was thought that the revenues generated by the value-added tax would allow reform and some simplification of the federal income tax system, but it is very doubtful that any proposal that involved adding one of these major alternatives without repeal of the federal income tax law could ever be a movement toward simplification of our tax laws.

The other basic approach to simplification is a broad-based federal income tax law which has a minimum of exemptions, deductions and credits, and thereby allowing a substantial reduction in tax rates. This probably represents the best promise for long-range, meaningful, substantial tax simplification. As I have noted before, the best presentation and analysis of this is the Treasury's Blueprints for Basic Tax Reform and the Special Committee on Simplification's analysis of the simplification aspect of the Treasury proposal. Again, however, there seems to be no realistic prospect of any such major revision being adopted within the foreseeable future. A central requirement in any move in the direction of a broad-based low rate income tax is an agreement that non-revenue policies will not be implemented through the tax laws. The movement on this key policy point, however, is in the opposite direction. Both parties, and particularly the Republican platform, looked to the tax laws as a vehicle for implementing a number of additional non-revenue policies. There is strong support for using the tax laws for innumerable non-revenue policies, and many believe that this is a way of implementing government policy without having direct government interference. Thus, I must conclude that there are no meaningful indications that either of the two possible approaches to broad simplification of the federal tax laws are under serious consideration at this time or likely to receive serious consideration at any time within the foreseeable future.

This brings us to the other approach to tax simplification which is to accept the present system and to work within it on a unit-by-unit basis. Of course, as mentioned frequently in my discussion, the Installment Sales Revision Act of 1980 is an illustration of this process. Here, there is more room for optimism, but, on balance, my conclusion is that we are likely to see an increase rather than a decrease in the complexity of our tax laws. I am encouraged by the simplification process that has been initiated, and I do anticipate that it will continue and that a number of the proposals set forth above and others yet to be developed will receive the attention and ultimately enactment under this process. However, I am gravely concerned that for every step forward, we will have at least two steps backward.

The real test for the strength and viability of simplification as a tax policy will come when it comes in conflict with other significant policies. I think we will see some important tests of simplification as a tax policy within the coming Congress, even at the first session. Let me

35 See note 23 supra.
illustrate some of the issues that I see coming before Congress which
have the potential for complicating our federal tax laws but which I
believe may well receive favorable treatment because of other con-
flicting and overriding goals. There are numerous proposals that would
allow additional credits. One might say, well, it does not greatly com-
plicate the tax law to add credit provisions, since it is just one more
offset to the tax after determining the tax liability. However, the
credits are a particularly pernicious form of complexity. It is a serious
mistake to evaluate the simplification aspects of tax credits by viewing
only the additional verbiage to the Code or the additional line to a
tax return. Credits seriously erode the tax base. If we assume, as seems
to be the case, that a fixed amount of revenue must be raised, as the
tax base is eroded revenue must come from other sources. This re-
stricts the ability to lower rates and often requires an increase in rates.
High rates are themselves one of, if not the most important cause of,
complexity in the tax law. Secondly, credits are frequently a cause of
what I have described as dynamic complexity, because they lead tax-
payers to make investments and take economic action in a greater degree
than would otherwise be the case. They lead to many complex and
elaborate planning devices to generate the credits and, of equal im-
portance, to use the credits. This can be seen in the investment tax
credit where very elaborate programs have been developed in order
to shift credits to investors who can use them and from the normal
user such as the airline or train industry which cannot make effective
use of credit.

Withholding has greatly simplified the tax law and one can only
wonder where we would be today if we did not have withholding on
earned income. Obviously, proposals to withhold on dividends and
interest are not being well received in or out of Congress and the
withholding on earned income is being seriously eroded by the inde-
pendent contractor issue and by the so-called “underground economy.”

Another proposal with laudable goals but which sharply conflicts
with simplification is the proposal to allow charitable contributions as
“above the line” deductions to those who otherwise claim (properly
now “the zero bracket amount”) the standard deduction. It is per-
haps correct to state that the most significant simplifying aspects of
our present tax law is the standard deduction. The Tax Reduction and
Simplification Act of 1977 was a movement towards increasing the
importance of the standard deduction. Allowance of charitable deduc-
tions in addition to the standard deduction will require all those using
the standard deduction to maintain records on contributions and
require the Service to audit this portion of those returns. The latter will
be particularly burdensome. Frankly, there is a genuine concern that this

36 It is now estimated that almost 80% of individual tax filers use the zero
bracket amount (standard deduction), Issues in Simplification of the Income Tax
Laws, supra note 10, at 58.
proposal will lead persons claiming the standard deduction to claim unsupported charitable contributions.

In the Revenue Act of 1978, we saw some amelioration of the very high capital gains rates. In 1981, we may see a further movement in this direction. Again, this illustrates a conflict between tax policy goals. While these reductions in capital gains rates can certainly be defended on goals of encouraging capital investment, adjustment to inflation and/or equity, they put increasing emphasis on the distinction between capital gain and ordinary income. As such, they are complicating factors and encourage dynamic complexity for persons seeking to re-adjust their activities and investments to qualify for capital gain treatment. Many of the provisions of subchapter C, section 1245, section 1250 and numerous other provisions take on increased significance as the differential between capital gain and ordinary income rates increases.

Indexing is a matter whose time may have come. Simple indexing of rates, exemptions and certain other specific dollar amounts need not add serious complexity, although there are always transitional problems and planning techniques of shifting matters from one year to another. However, major proposals call for indexing of assets which are subject to the depreciation deduction and to capital gain treatment. Any study of such proposals demonstrates the enormous complexity of these proposals. Furthermore, if assets are to be indexed, then there will be an inevitable pressure to index liabilities and this adds a whole new dimension of complexity. Even the most popular depreciation proposal, known as the 10-5-3 proposal, which may at first viewing be considered a plus for simplification does in fact have a number of serious complexities when studied in detail. By separating economic life from depreciation life numerous types of shelter programs can and will be developed, and through these a major form of dynamic complexity.

It will be interesting to see what role simplification will play as a tax policy in the evaluation and action on these and other major tax proposals. If the learning of the past is a guide, one cannot be optimistic that simplification goals will play any significant role in the final decisions. Thus, I am forced to the conclusion that while we can hopefully look to a continuing and growing interest in simplification as a concept and while we can hope that specific legislative proposals will be processed along with the lines discussed in this paper and illustrated by the Installment Sales Revision Act of 1980, there is no realistic prospect of major tax simplification in the foreseeable future. The major policy considerations that will generate tax legislation in the 1980's seem to be generally in conflict with simplification as a tax policy. I am thus led to the conclusion that simplification will not play a major role in the tax policy, at least within the next few years and

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\[37\] See, e.g., Evaluation of the Proposed Model Comprehensive Income Tax, Select Committee on Simplification, Section of Taxation, American Bar Association, supra note 24, at 640-647.
perhaps not even in the long run. Nevertheless, it is important that simplification be championed and that this cause receive broad attention. While it may not prove to be a dominant force, it has definitely grown in significance, and this movement may at least serve to ameliorate the complexity we would otherwise see from the proposals under consideration and to be considered.