

# SYMPOSIUM: FEDERAL TAX POLICY IN THE NEW MILLENNIUM

## Introduction

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Our federal income tax law is under the strongest attack since the Sixteenth Amendment was ratified in 1913. The most vocal assaults began during the 1996 presidential campaign, most notably with candidate Steve Forbes' call for a flat tax to replace the current structure.<sup>1</sup> Voters were told that under a flat tax most taxpayers would be able to file a postcard size tax return each year.<sup>2</sup> The calls for reform peaked when the House of Representatives passed the Tax Code Termination Act of 1998.<sup>3</sup> The Act called for repeal of the tax code by December 31, 2002, provided that an alternative system was in place by July 4, 2002. Although the vote was fairly close at 219-202, and the bill was passed during a congressional election year, the Act is symbolic of the frustrations of Congress with the current federal income tax system.

The federal income tax had a very humble beginning in 1913. The entire law consisted of only 14 pages,<sup>4</sup> and the first individual income tax return (Form 1040) was a mere three pages with one

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<sup>1</sup> See Ernest Tollerson, *Bowing Out: Forbes Quits and Offers His Support to Dole*, N.Y. TIMES, Mar. 15, 1996, at A26 (recapping Steve Forbes' campaign for the presidency).

<sup>2</sup> See ROBERT E. HALL & ALVIN RABUSHKA, *THE FLAT TAX* 52 (2d ed. 1995) (the flat tax proposals of both Steve Forbes and Congressman Arney were based on the Hall and Rabushka proposal).

<sup>3</sup> Tax Code Termination Act of 1998, H.R. 3097, 105th Cong. (1998).

<sup>4</sup> Tariff of 1913, ch. 16, § II, 38 Stat. 114, 166-81 (1913).

page of instructions.<sup>5</sup> Now there are more than 2,700 pages in the Internal Revenue Code and about 400 schedules and forms.<sup>6</sup> Obviously much has changed since 1913, with the federal government's appetite for revenue significantly enhanced by two world wars, military defense, Social Security and welfare programs, and interest on the public debt from deficit spending.

Since Congress recodified the Internal Revenue Code in 1986,<sup>7</sup> there have been significant amendments in 1990,<sup>8</sup> 1993,<sup>9</sup> 1996,<sup>10</sup> 1997,<sup>11</sup> and 1998.<sup>12</sup> Congress has been extremely active, with major income tax law changes in every year since the 1996 campaign debates about tax reform. Curiously, instead of adopting a revolutionary new tax scheme, Congress has refined the present system and added to its complexity. The system has become so complex that some political pundits have speculated that it is all a ploy by Republican congressional leaders to scuttle the whole system by causing complete exasperation within the populace.<sup>13</sup>

As evidenced by the Tax Code Termination Act of 1998,<sup>14</sup> the political winds of change are in the air as we get closer to the new millennium. Although calls for tax reform have subsided since the November 1998 congressional elections and the preoccupation of Congress with the impeachment process in early 1999, there is little doubt that tax reform will again be a battle cry of politicians during the presidential campaign in the year 2000.

Chapman University School of Law has a mission to develop a tax law concentration of distinction. To that end, Chapman offers a tax law emphasis program as an integral part of the J.D. curriculum. Chapman is also the only law school in California, and one of only 12 American Bar Association-approved law schools in the nation, that participates in the United States Tax Court clinical

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<sup>5</sup> See Sharon C. Nantell, *A Cultural Perspective on American Tax Policy*, 2 CHAP. L. REV. 33, 90-93 (1999) (Appendix reproducing 1913 Form 1040).

<sup>6</sup> See U.S. GENERAL ACCOUNTING OFFICE, REPORT NO. GGD-98-37, TAX ADMINISTRATION: POTENTIAL IMPACT OF ALTERNATIVE TAXES ON TAXPAYERS AND ADMINISTRATORS 39-40 (1998).

<sup>7</sup> Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

<sup>8</sup> Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990).

<sup>9</sup> Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993).

<sup>10</sup> Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755 (1996).

<sup>11</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).

<sup>12</sup> IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998).

<sup>13</sup> See Jonathan Chait, *The Flat Tax Scam: What Dick Armev Doesn't Want You to Know*, NEW REPUBLIC, Dec. 15, 1997, at 24.

<sup>14</sup> See *supra* note 3.

education program. Our law students handle actual cases docketed with the court on a pro bono basis.

For a law school with taxation law as a component of its mission statement and curriculum, we accordingly focus this issue of the *Chapman Law Review* on a critical examination of our present federal income tax system and possible alternatives. Chapman is proud to have sponsored the Second Annual Tax Law Institute on November 12-13, 1998. On November 13, 1998, the topic was "Federal Tax Policy in the New Millennium." Distinguished tax law policymakers, professors and scholars from around the country came together to present their ideas, research and analyses with respect to federal tax reform. The participants included Jonathan Talisman, Deputy Assistant Secretary for Tax Policy, Department of the Treasury; Professor Sharon C. Nantell, Chapman University School of Law; Professor Barbara H. Fried, Stanford University Law School; Professor Jonathan Barry Forman, University of Oklahoma College of Law; Professor Edward J. McCaffery, University of Southern California Law Center; Professor Alan Schenk, Wayne State University Law School; and Professor Lawrence Zelenak, University of North Carolina School of Law.

Chapman is pleased to have these respected educators and scholars present their in-depth legal and economic analyses in this law review. We are confident that readers will find these works to be at the cutting-edge of a philosophical and critical study of the alternatives to the most significant tax law in the history of mankind.

Although the scholars may differ on some issues, they all agree that the Congress should carefully explore alternative schemes before scrapping our current income tax law. Our current law is primarily a byproduct of the 1954 Internal Revenue Code, with an inordinate number of refinements since then. Even House Majority Leader Richard Arme, one of the leading advocates of a flat tax, does not support a new tax plan that is entirely free of loopholes.<sup>15</sup> Also, many of his colleagues are critical of any plan to end the deductions for home mortgage interest and charitable contributions.<sup>16</sup> These inconsistencies are just the tip of the iceberg when one tries to sort out the drawbacks of revolutionary tax reform.

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<sup>15</sup> H.R. 2060, 104th Cong. (1995) (Congressman Arme's flat tax proposal, excluding investment income from the tax base, and providing for substantial personal and dependent standard deductions).

<sup>16</sup> See, e.g., The National Commission on Economic Growth and Tax Reform, *Unleashing America's Potential: A Pro-Growth, Pro-Family Tax System for the 21st Century*, reprinted in 70 TAX NOTES 413 (1996) (commonly referred to as the "Kemp Commission Report").

Further confusing the colloquy is a commonly held belief that high income taxpayers are able to shelter much of their income from taxation. In truth, the current income tax law is remarkably efficient in taxing the rich. On December 14, 1998, the nonpartisan Congressional Joint Committee on Taxation released a report showing that individual taxpayers with incomes over \$100,000, less than 10% of the total population, are projected to pay 62.4% of the total income tax burden in 1998.<sup>17</sup> The ability of high income taxpayers to shelter their incomes diminished to a great extent as a result of the Tax Reform Act of 1986,<sup>18</sup> followed by further increases in the burden on the wealthy in the 1990 and 1993 tax acts.<sup>19</sup>

Nevertheless, along the way the federal income tax has become a very complex law.<sup>20</sup> Even the experts who make a living interpreting and applying tax law for their clients have voiced frustrations at the inordinate complexities. The American Bar Association and American Institute of Certified Public Accountants have called on Congress on numerous occasions to simplify the income tax law.<sup>21</sup>

Consequently, as we enter a new millennium, we urge the policymakers to study the works in this law review. The current tax law is fundamentally sound in my view, but we need a comprehensive overhaul to eliminate the complexity.<sup>22</sup> Much of the convoluted state of the law is due to tinkering by Congress to placate powerful lobbying groups and satisfy purely partisan political goals. We can only hope that the Congress can at last overcome the pressures of lobbyists and partisanship and erase from the Internal Revenue Code all of the needless complexity.

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17 JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 1999-2003, at 25 tbl.2 (JCS-7-98 1998).

18 Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) (major changes included the repeal of income averaging and the regular investment tax credit, new limitations on tax shelters, limitations on the deductibility of nonbusiness interest, and the addition of a new generation skipping transfer tax).

19 Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11101, 104 Stat. 1388, 1388-403 to 1388-405 (1990) (increasing the highest individual tax rate to 31%); Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §§ 13201-13202, 107 Stat. 312, 457-61 (1993) (increasing the highest individual tax rate to 39.6%).

20 See, e.g., Deborah L. Paul, *The Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?*, 76 N.C. L. REV. 151 (1997).

21 See, e.g., Michael C. Durst, *Report of the Second Invitational Conference on Income Tax Compliance*, 42 TAX LAW. 705, 728-30 (1989) (discussing the impact of complexity in fostering noncompliance, and advocating a pilot project with other professional groups to advise Congress of potential problems with complexity of pending tax legislation); *Impact of Complexity in the Tax Code on Individual Taxpayers and Small Businesses: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 105th Cong. 31 (1998) (statement of Michael Mares on behalf of the American Institute of Certified Public Accountants); *AICPA Submits Tax Simplification Recommendations*, TAX NOTES TODAY, May 15, 1997, at 25.

22 For a contrary view, see William W. Oliver, *Why We Should Abolish the Income Tax*, TAX NOTES TODAY, Feb. 3, 1997, at 70.

Although it is a cliché, this symposium has truly been a collaborative effort, and there are many people to thank for making this law review a reality. We appreciate the support, encouragement and leadership of Dean Parham Williams and Professor Denis Binder, faculty advisor to the law review. We are very grateful to all the dedicated editors and staff of the *Chapman Law Review* who worked so hard to put the symposium and law review together. A very special thank you should go to Editor-in-Chief Diana Hoffman for putting the project together and keeping it on track. And, of course, we are forever grateful to and honored by the fine contributors to this work.