

The Erwin N. Griswold Lecture

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I am honored to have been asked to give this Griswold lecture. Erwin Griswold was one of the truly greats of the tax world. I was fortunate to be able to serve with Erwin; he was Solicitor General for some of the time that I was Commissioner of Internal Revenue. We had a close and wonderful working relationship. Judge Tannenwald, who introduced me, has served on the Tax Court for over 30 years, much of that as Chief Judge. He is one of the finest Judges who has ever served on that Court.

I have been fortunate during my career to have known and worked with a number of the truly greats of the tax field, including all of those who preceded me in giving this lecture. Boris Bittker, one of the truly great teachers of tax law, and the law of life. He was on the Commissioner's advisory group for me and has been a friend of many years standing. Eddie Cohen was active in the ALI study which preceded the 1954 Code and was the model for our work on that Code. I was the youngest person on the staff working in 1954; Eddie was in to see us regularly to try to improve our drafts. He was a great teacher and Undersecretary of Treasury for Tax Policy. Jack Nolan has been a friend for as long as I can remember. I consider him one of the very best of the ABA.

In my youth I was privileged to grow up in the old Legislation and Regulations Division of the Chief Counsel's Office where many leading lawyers began their experience. When I left the Government, I worked for the Paul, Weiss firm. I was interviewed when Randolph Paul was still alive, but came to the firm after his death. He died, as some of you may recall, while testifying in favor of tax reform in 1956. My mentors were Carolyn Agger and Louis Eisenstein. Carol died just about two months ago. She was a partner in a major law firm when women were not hired by law firms and she was a great lawyer and wonderful person. Louis Eisenstein, who is little known today, was probably one of the outstanding tax theoreticians in the field in the 1950s-1960s. He unfortunately died early at the age of 50 in 1965. Many of my ideas were influenced by him, and his wonderful book, *The Ideologies of Taxation*.

Every one of us owes the deepest respect, however, to Stanley Surrey. I noted that each of the others who have given this lecture has given Stanley credit for his magnificent contribution to the tax field. Stanley was the fountainhead for much of the legislation of the last forty-five years. Stanley served in the Treasury before World War II, taught in California and then became the premier tax theoretician during a long stint at Harvard. He served eight years as Assistant Secretary of Treasury for Tax Policy under Presidents Kennedy and Johnson. I was privileged to know him and work with him during much of that time. Our only real differences were over scope, not direction. Stanley liked the grand gesture; I was for incremental improvement. Today Stanley is not here to defend himself, but I will still be for incremental improvement. Grand gestures cost too much; they bring out all of the factions and forces which have corrupted the present system.

Modern taxation or tax-making in its most characteristic aspect is a group contest in which powerful interests vigorously endeavor to rid themselves of present or proposed tax burdens. It is, first of all, a hard game in which he who trusts wholly to economics, reason, and justice, will in the end retire beaten and disillusioned. Class politics is the essence of taxation.¹

Or, to put it in more modern terms, "Our taxes reflect a continuing struggle among contending interests for the privilege of paying the least."²

¹ T. S. Adams, *Ideals and Idealism in Taxation*, 18 *Amer. Econ. Rev.* 1 (1928).

² Louis Eisenstein, *Ideologies of Taxation* 3-4 (1961).

First, like all "old timers," I will tell you things were better in the "good old days." They were not, but they seemed to be because we were all less sophisticated than you are today. Yes, I can tell you the Code was less than one inch thick when I started. The income tax regulations were likewise only one inch thick. But there was no accelerated depreciation, no derivatives, foreign tax virtually did not exist, trust law was only beginning to develop, and partnerships were covered by one provision.³

Each of these changes, of course, has its supporters. Some were inserted to benefit one taxpayer or a small group, some to restrict taxpayers from what the Congress considered unjustified benefits. All were judged by the Congress to be worthy. Many of them are--but what is the price of such specific legislation. Complexity. Change is complexity; complex change is the present Code.

Administratively the IRS in the 1950s was a mess. The modern IRS was born in 1952 as a result of the King and Kean hearings. The Collectors who had been appointed politically were replaced by a career service of excellence and the modern tax system began to shape up. By the time I returned to the IRS in December 1963, computers were being planned, but not yet implemented. A career civil service now operated, and except for the Commissioner and Chief Counsel, everyone else in the building was career (and I mean everyone, even special assistants were career people). With all of its faults, and there are many, it is still one of the best systems of administration in the world. I have gone all over the world for CIAT (Interamerican Center for Tax Administration), the UN, and other international groups and everywhere our system is admired. Only here is it derided. One of the serious problems of our system has come from the amazing ability of the IRS to administer the complex law. This seems to embolden the Congress with pushing more and more tasks onto the IRS.⁴

Everyone today wants to talk of simplification. Very few really want to do anything about it. In 1966 the economy started to steam up, so the President suggested a one year suspension for the ITC (which I had opposed in any event). We drafted a one page suspension, it started on Day 1, renewable on Day 366. The followers of equity, power, lobbying, call it what you will, returned a bill 35-40 pages long. Each exception had its own justification, some real, some imaginary. I don't say the resulting legislation was bad, but it was certainly complex.

In 1982 Senator Bob Dole suggested we have withholding on dividends and interest. His suggestion was for a very simple plan of a flat 10 percent withheld from every payment of dividends or interest. This would have required almost no complicated record keeping or reporting. Everyone could have grossed up and known how much to report. However, the banks and other financial institutions were not happy with this. After all they had the use of the float on which to make a profit. I deposited my dividend in my account and did not withdraw it until April 15 when I had to pay my tax, so the bank held my money (or better the tax collector's money) for a number of months. It could make money on that money. So the banks and other financial institutions started a lobbying effort to protect widows, orphans, and exempt organizations, but really themselves. They added complication upon complication to protect each group. Congress went along; then the banks and financial institutions opposed the bill, which now provided a myriad of exemptions, as being too complicated. I suspect I would call that the height of

³ A quick perusal of the Code would show hundreds of provisions added since 1954. Each has its own reasonable justification; each adds its own complication. For example, there is a retirement credit, an adoption credit, a credit for fuel from unconventional sources, a work opportunity credit, the AMT, a 2% floor on deductions, a limitation on itemized deductions, cafeteria plans, educational assistance programs, dependent care programs, adoption assistance programs, private activity bonds, arbitrage bonds, stapled entities, the tax treatment of political parties, golden parachutes and on and on.

⁴ Organized crime drives, chasing drug pushers, following wayward fathers, finding deadbeats on college or other loans and on and on.

chutzpah. (You will recall the definition of chutzpah as "a boy who murders his father and mother, then throws himself on the mercy of the court as an orphan.")

That compilation reminds me of the fight back in the early 1960s over withholding on dividends and interest. Again, the Treasury asked only for a flat percentage withheld on every dividend or interest payment. We have a lower rate of compliance for reporting dividends and interest than we do for salaries. Ninety-eight or ninety-nine percent of salaries are reported when there is withholding, while only ninety percent of dividends and interest are reported on returns where there are 1099s but no withholding. Senator Byrd of Virginia--then Chair of the Finance Committee--fought the Kennedy Administration and Stanley Surrey to a standstill. Then they settled for 1099 reporting with elaborate penalties and reporting devices. Are the banks and other entities better off with the compromise than the original proposal? I doubt it, and I know the system is more complex and most of us are worse off.

The good things we were able to do in the last 30 years or so were mostly administrative. We succeeded in installing the modern computer system; six of the first of seven computer installations were built in my administration. (Unfortunately that system is still in place and has never been renewed by major improvement. I left plans for a system for the 1970s, but Congress refused to appropriate the funds, as it did with a system in the 1980s). We went for centralized filing at Service Centers rather than filing in 68 districts. The ABA and AICPA were less than helpful in this regard. They were concerned with their own interests on various points and thus they made the statute more complicated than it needed to be. The last districts to be abolished before the recent changes were in my day when we eliminated a number of districts and one region. We reduced 15,000 personnel or more in the districts and did it without having a reduction in force (RIF). This was a tribute to the career IRS staff.

The audit rate in 1964-68 was about 4.5 to 5 percent, compliance was over 90 percent; today the audit rate is less than one percent⁵ and compliance is only about 80 percent. Think there is a correlation? I do. The Taxpayer Compliance Measurement Program started in December 1965. It was a great risk, the opportunity cost was hundreds of millions of 1960 dollars (billions in inflation adjusted dollars today). From that came the DIF formula which selects returns for audit. When we started, 50 percent of individual audits resulted in no change; that is, the audit found no deficiency. As a result of DIF and TCMP, the no-change rate fell to less than 20 percent. What an improvement! More revenue while auditing returns that are incorrect rather than those that are essentially correct. Sample audits do annoy some people, but there is tremendous benefit to the tax system and the bulk of the taxpayers. This simplification has no constituency; some few people complain about inconvenience of a TCMP audit, and the program was recently killed.

The last year I was Commissioner was the last year the United States had a balanced budget. All this was before indexing. Indexing is fair, but does it work? No. It takes all the pleasure out of serving on the tax committees.

Before indexing, the percentage of GDP taken by the tax system remained stable over a 10-year period. The Committees could cut taxes every few years, but that exercise gave them leeway to correct inequities. Now, with indexing of benefits and rates and the push to gain fiscal control there is no cushion, so it is much more difficult to correct inequities without raising someone's tax. Yes, indexing is fair; yes, it causes many of our problems. (Now we see a study of whether the CPI Index is fair or overstated).

Tax simplification has no constituency. We are all for it in theory, however, we oppose it in practice. To quote Pogo: "We have met the enemy and it is us."

⁵ By redefining what is an audit, the IRS reports a higher percentage.

How many of you remember the Tax Section's efforts for tax simplification in the early 1960s? You met the same forces that the Congress meets: your clients, various interest groups and factions. As I recall it, you punted. The Tax Section gave up the study and turned it over to a commission. That is what Congress does with regularity. When a problem is too difficult to solve, punt to a commission. We are all for tax reform, but that is in the abstract. Larry Woodworth and I designed a deadwood repeal bill to clear the Code of archaic provisions which no longer applied; they cluttered the Code and were required to be read to see if they applied. It took 10 years to pass it. (Drafted in 1967, passed on October 4, 1976, part of the Tax Reform Act of 1976). No one in Congress or on the staff was really interested.

Years ago I learned that the income tax is not the only tax that can be "gamed." I was in Chile in 1966 to help with their tax system. On the way in from the airport I saw a small French car with a sloping back. On the back was a small 3' x 3' platform. I asked what that was and was told: "It is a truck." The excise tax on automobiles was 200 percent, while the tax on trucks was 30 percent, so it was a truck. Thus, unless your drafting is done carefully and thoughtfully, someone will attempt to game the system, whether it is an excise tax or income tax.

Our friends who favor the flat tax or the VAT or some other "new" tax will tell you that if you enact their system with no changes you will achieve the nirvana of simplification. Will the Congress enact their system with no changes? I doubt it; the Congress never enacts the Administration's suggestion (whether it be Democratic or Republican) with no changes. Thus, we end up discussing unreality. The cry to adopt our system as it comes from our laboratory is doomed to failure on day one. Those competing interests or factions have not yet come to deal with it.

Some people have suggested that in order to keep the Congress from raising taxes we should require a supermajority, like 60 percent, in order to raise taxes. However, they then worry a little and put in an exception or two. For example, they say that when the country is at war a majority vote would do. It is passing strange in a democracy that we would allow a minority to control the fate of the country or that we would have the confidence that the Congress could enact a law which is so perfect that it needs no changes.

Let me hypothesize a situation which arises almost annually. Congress enacts a provision which it estimates would raise \$X but after six months it is clear they made a mistake and it only raises \$1/2X. Now to raise the tax we need 60 percent; so the 40 percent controls. Is this the type of democracy we want?⁶

I could be cute and suggest that this is a perfect analogy to the movie many of you may recall: The Mouse That Roared. You will recall that a small, broke duchy declares war on the United States so it can lose and then get something like the Marshall Plan. Here I would suggest we declare war on Grenada (as we once did). Declaring war only needs a majority vote. Then at war we can raise taxes with only a majority vote. You and I know I am being silly, but I hear grown men and women making statements not too dissimilar to those I have made here.

Years ago when I was Commissioner of Internal Revenue the ABA Tax Section leadership called on me as they call on the commissioner each year. I told them my greatest concern was not with their clients because they were ably represented. They brought the needs, wants, and desires of their clients forcefully to my attention, and to the Congress' attention. What concerned me most were the lives and economic hardships of those who were not represented.

⁶ I understand the House has adopted a rule which requires a 60% vote to increase taxes. That rule has been in effect for two years and has been waived four times; once for each bill as it came up.

Most of us are blissfully unaware that the average family income in the U.S. is about \$33,000 or \$34,000 per year. (It was \$31,241 in 1993). Less than six percent of households have incomes of \$100,000 or greater. Thus, we can see that most of us do not really deal with "average" taxpayers. We don't even know average taxpayers. We are only dealing with the upper three or four percentage of taxpayers. Yet we all seem to assume that what we see is the universe. We are really all like Gulliver in his travels to strange worlds. Each world assumes it is the universe. It is not, each is only a speck in the universe.

The tax system to the average person is withholding, standard deductions, 1040A or 1040EZ. Almost three-fourths of the population fall in that area and to them the system is about as simple as it is going to get. Each time you broaden the standard deduction or personal exemption, you make it simple for more people, but the price gets higher and higher. That is because you are giving deductions or tax breaks to those who don't give to charity, don't have high medical bills, and don't own mortgaged homes. Ask anyone who has been in on the planning of the simplification of the Code. As you know, the tax on Form 1040A need not be calculated. You can mail the form to the IRS and it will send you a bill. Yet more than 80 percent of the 1040A's come in completed. This is not an issue of simplification or complexity; it is that the taxpayer wants to know what he or she owes, or what is due from a refund. Therefore, the privilege of having the IRS computer do the calculation is rarely used.⁷

It is easy to plan on tax simplification by yourself. It is a little harder to do with a small committee, since a small committee has divergent ideas, needs, and wants. The larger the group doing the job, the tougher it becomes, until it gets to be the whole United States.⁸ Then you get the type of bill designed by the committees of Congress. As Eisenstein said in *Ideologies of Taxation*, "Our taxes reflect a continuing struggle among contending interests for the privilege of paying the least." And remember, the poor and the working poor are not at the negotiating table. Only our clients, and those like them, are represented.

I recently had occasion during the fall election campaign to write critical letters to both candidates on their tax proposals. How many of you did this?

President Clinton suggested an educational tax credit of \$1,500 per year for two years or a \$10,000 tax deduction for educational expenses. This was for the laudable goal of providing at least a two-year community college degree for anyone who could qualify. Of course, not wanting to fritter money away, the President put in some restrictions, such as maintaining a "B" average. (Back in GI Bill days, we only had to maintain the average the school required; usually "C." I should add that I am a great backer of scholarships since I attended undergraduate school on the GI Bill and law school on a full three-year scholarship). In my letter to the President, I indicated my objection to his proposal on a number of grounds. First, it cluttered up the Code with pages of material related to education; not taxes. In other words, this was an education program, not a tax program. The onus was on the IRS when it really belonged on the Department of Education. IRS personnel would be monitoring report cards; is that what we want from them? The biggest objection, however, is that the idea is economically wasteful. If you

⁷ In 1965 we tried an experiment of a questionnaire form. No calculation need be made. The form was in Q & A style rather than accounting style. Experimental groups liked it by a heavy percentage. However, we tried it on a large sample of about 170,000 and it flopped. In spite of being much easier for many people, it flopped because people when they finished wanted to know how much they owed or how much refund they would receive. A questionnaire does not tell you this. If you supply the schedules to make the calculation, you have not simplified the return.

⁸ Until 1975, the Ways & Means Committee had only 25 members. In 1975, it was increased to 36 members and then in 1993 to 39 members. Think of how much harder it is to chair such a large committee and to keep the group moving in terms of substance and administration.

wanted to educate young people, it would be a lot cheaper to use scholarships or student loans. There is a bigger bang for the bucks you choose to spend. Putting a program in the Internal Revenue Code opens it for everyone, which is good, but raises the cost. Then to keep the cost down you will lay on restrictions and exceptions and rules.⁹

Bob Dole also got one of my letters. His plan was for a charitable tax credit (\$1,000 per married couple, \$500 per individual) for contributions to a charitable organization if the organization spends 75 percent of its funds for poverty relief. Again, I had a number of complaints. First, it is a social welfare plan but administration would be pushed on the IRS. Then, it would be wasteful since many of us already give to charitable organizations which fit the description. If you tried to use an incremental credit you would run into the same buzz-saw that President Kennedy did on the original proposal for the ITC: excruciating detail and political impossibility.

I have suggested, as have many others, that all serious tax proposals should be accompanied by a draft of the form and rules to effectuate them. This might have a sobering effect, but I suspect it would become a ritual and no one would pay attention to the layers of complexity added by new proposals. After all, none of us have ever seen a client complain about the complexity of a provision which benefits them. It is only when it costs us that we care.

The ideas of tax nirvana seems always to elude us. But like Don Quixote, the quest is the thing. Remember my beginning quote from T. S. Adams. It is not economics we are talking about, it is taxes. It is a group contest to see who pays less.

Believe me, if the rich paid more in a VAT or so-called flat tax, Dick Arme and his brothers and sisters would be for some other device. We can have a simple tax any day we choose. All we need are members of Congress and Senators who put administration and simplification first and the desires of special or just plain interest groups second. What I am saying really is that the emperor has no clothes. Why should any rational person who has viewed the tax system, as I have, for 45 years, believe for one minute that the Congress, which brought us the AMT, Subpart F, private activity bonds, LIFO, to cite a few examples, can enact a statute which is simple and direct and has no exceptions. And, if Congress could enact it today, could it resist making a change to close a loophole or open one for a needy case tomorrow? And, if it did, would it have the same concern for administrability and understandability that we have today? I think experience tells us, NO.

My friend, Louis Eisenstein, at his death in 1965 was writing a piece he called a Modest Proposal; some of you may recall Swift's Modest Proposal. Eisenstein proposed that we invert the tax schedule. Thus, high income taxpayers would be in the 15 percent bracket while the working poor would pay the highest rate, 39.6 percent. This would meet the supply sider's arguments, the high income people having a low rate would invest more heavily in socially desirable investments (or, from my experience, in less socially desirable investments) and the low income, highly taxed people would have a strong incentive to work hard, get out of poverty and pay less in taxes. Most of you will laugh; so will I, but I suspect we find differences immediately. Can the migrant worker succeed in a high tax regime? I do not think so. And what will this do to the fabric of our social system? Think about it. It may be more extreme than the VAT, USA, sales tax or similar ideas, but only by a little.

⁹ For example, recent studies have shown that the credit may be wasteful. States and local schools may raise their subsidized rates to absorb the credits allowed. Thus, many California community colleges only charge \$365 per semester. If the federal credit is higher, who would object if they raise their charges? See Martin A. Sullivan, Clinton's Proposed Tuition Tax Breaks Raise Questions on Several Fronts, 73 Tax Notes 1257 (Dec. 16, 1996).

Then, what is the solution? I guess that makes me a raging incrementalist. I used to fight with Surrey who was so much smarter than I and wanted the world to be perfect. He was for big sweeping changes. I would settle for the Ways and Means Committee and its staff to work on one area of the Code at a time and try to make the rules more rational and workable. Then, when one area was done the Committee could, if it could hold its discipline, move to another area, and so on.¹⁰ But, Congress' attention, like a child's, is short so I am not sure it will work, but I suspect this plan has less opportunity for mischief than any other route now under consideration.

I ought to close by saying that high taxes don't ruin the economy. We had rapid and sustained growth in the Korean War period. The rates were outrageously high, but we had a balanced budget and relatively low inflation. I read an op-ed piece in an Israeli publication recently which said they should not follow our lead to lower tax rates; you see, their growth rate is close to 6 percent, while ours is 2.5 percent. High taxes do not mean low growth; it is how you spend the money and whether you balance the budget which counts.

I find some of the balanced budget talk to be complete nonsense. Many states have balanced budget requirements, but those that do have capital budgets which don't count. Only the amortization of the debt and interest on long-term assets count in the current budget. Why do politics get mixed up in technical issues like this? Because it is money and we all want to keep as much as we can. That is the basic law of economics as I learned it: "Man's wants are insatiable." So, I hold no Holy Grail; I had my balanced budget in my last year in office. We had two-to-three percent interest on government bonds and three percent interest on savings. Now it is the next generation's turn. So far, our friends, the Congress and both political parties, have ducked, and my guess is they will continue to do so. Neither side wants to take the blame for screwing up a system; with all its defects, the present system works.

If we could find the perfect tax system, one that we could all agree would work (a doubtful assumption); we would still have the god-awful task of how to move from the old system to the new. Those of us in this room have some idea of those complexities. Those in the general public have none; the Congress only vaguely understands.

If we go to a consumption tax; we are pitting the young against the old, and the poor against the rich. The old have paid tax on much of their savings; are they to be taxed again on expenditures? The rich save and thus would pay lower taxes then; the poor must spend all available funds, so are taxed more heavily. Some say they can make a consumption tax more equitable. I suspect that if you try it, it will end up looking like the present Code, but we may see it yet.

If I bought a new asset six months before the new system and based my financing on the present tax system with depreciation, interest deductions, and the like, how will it work in the new system where capital goods are deductible and have no depreciable basis?

So here I stand worried about the debt we are running up and laying on my children and grandchildren just like the rest of you. The answer I am after is in our civics class. If we want better government, we need to have better people involved in it. Yet today many of our best people shy away from government service. I would start right there. If we all did a little more to encourage good people to go into government service, perhaps we could move the system just a bit. Write your Congressperson today. Don't ask for a benefit for yourself or your client, ask for more administrable rules with changes less often. That will be a good start.

¹⁰ Wilbur Mills in his heyday made this suggestion, which, of course, like all really good ideas was left fallow. It takes discipline to follow this course, and Congress, like the rest of us, has no discipline.

I guess I end up again as a raging incrementalist. I wanted to close on an inspirational note and I could not find much so I looked back to one of my favorite authors and I came up with Thomas Wolfe. In his *You Can't Go Home Again* he said "I think the true discovery of America is before us. I think the true fulfillment of our spirit, of our people, of our mighty and immortal land is yet to come. I think the discovery of our democracy is still before us and I think these will come as certain as the morning and is as inevitable as the noon." He went on to say that the enemy is before us. The enemy is simple selfishness and compulsive greed and we have to go out and overcome it.

Most of the people in this room are trying in their way. I am trying to exhort you to do more because we know more. Thank you.

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