

2001 ERWIN N. GRISWOLD LECTURE BEFORE THE AMERICAN COLLEGE OF TAX COUNSEL: ERWIN GRISWOLD'S TAX LAW—AND OURS

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It is a pleasure for me to be here today to deliver the Erwin N. Griswold Lecture. And it is an honor to follow those who have graced this lectern before me. They include important mentors to me. Several are close friends.

Today, we are in a quiet interlude awaiting the next serious political debate about restructuring the nation's tax system. No fundamental tax policy concerns are at stake in the current disputes over economic stimulus or in the political huffing and puffing about postponing or accelerating the income tax rate cuts of the 2001 Act. Those arguments are concerned principally with positioning Democratic and Republican candidates for the 2002 congressional election, not tax policy.

But the coming decade with its paint-by-numbers phase-ins and phase-outs of 2001 Act tax changes, the tax cuts waiting to spring into effect, along with the sunset of the entire Act in 2011, makes this a propitious time to take a hard look at the nation's tax system. It is impossible to describe the nation's current tax system in anything other than tentative and uncertain terms. Even the most sophisticated tax lawyer cannot be sure what the current statute means for the future. Should we, for example, believe that more than 35 million taxpayers—nearly one-third of all individual filers—will be subject to the alternative minimum tax, as the current law implies, or should we instead be confident that some future Congress will avert that train wreck? Has the estate tax really been repealed? The 2001 law repeals that tax only for the year 2010. That is why Paul Krugman described that year as an auspicious time to “throw Mama from the train”—at least if she is rich.

There will be four congressional and two presidential elections before 2010. Absent a Constitutional amendment, President Bush cannot serve past January 2009. Congress enacted nearly 100 different laws amending the tax code in the fifteen years just past. The structure of the 2001 Act makes congressional reexamination of the nation's tax law inevitable.

Those of us who have an abiding interest in the nation's tax policy should treat the 2001 Act's sunset in 2011—its “Ax-the-Act” provision—as a unique opportunity to debate what kind of tax law should govern the nation in the 21st Century. We need to be prepared when a tax reform opportunity knocks. We do not have any stable status quo.

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Nor has it been easy to embrace the status quo for quite a long time. No politician spearheaded a save-the-code movement in opposition to the congressional Republicans' recent efforts to scrap the code by terminating it a decade hence.

But if we cannot admire the tax law we have, what should we wish for? Let me share with you some of my observations about the nation's current tax law, along with a few comments about its history and where I think we should be heading.

I knew Erwin Griswold, but he was not exactly a friend of mine. Dean Griswold and I first met in 1974 when Foundation Press was searching for a young law professor to update his tax coursebook. Only much later did I learn that the two previous honorees had busted out. After Erwin and I had exchanged numerous letters and Erwin had read the two articles I had then written, he finally suggested that we meet in his office at the Jones, Day law firm in Washington, D.C. Erwin began by instructing me that the proper function of the introductory course in taxation was to prepare a student who lands in solo practice in Kansas to answer any tax questions his clients might encounter. I responded that this goal was both impossible and inapt. "The tax law," I added, "is more important than that. It is the primary link between the nation's citizens and their government. Many more people file tax returns than vote in presidential elections. The politics of taxation has a major impact on electoral decisions at every level of our government." "The tax law," I continued, "is a window into the nation's views about justice, about how much economic inequality the society considers appropriate." "And," I said, "nowhere in American law is there a better place to examine carefully the premises of our adversary system and, in particular, the role tax lawyers play in working out the tensions between citizens' insistence that the government perform well its assigned functions, on the one hand, and each person's personal resistance to sacrificing private resources to the public treasury, on the other." Erwin scowled at me, barely indulging my youthful enthusiasms. Those of you who knew him well will not be surprised that he did not instantly capitulate. Nearly five hours later, after a long lunch, Erwin Griswold concluded our first meeting by observing: "Any book that can satisfy both you and me should have a broad market. Why don't we give it a try?" The first edition of Griswold and Graetz was published two years later in 1976. The fourth edition of its successor Graetz & Schenk—Deborah Schenk of the NYU Law School—was published in September 2001.

Erwin's book, first published in 1940, was the first law school coursebook on the subject of federal taxation. It took a person of Erwin Griswold's stature and tenacity to convince Foundation Press that the subject of federal taxation warranted its own coursebook. Erwin's organization of the material is still widely followed, not only in our book, but also by nearly all of the fifteen or so other income tax coursebooks now in use. And much of the material covered in Erwin's first edition—the pages devoted to corporate income taxes and estate and gift taxes—now must be found in other books designed for separate courses. Erwin could not have anticipated that the last two chapters of our book today

would be devoted to minimum taxes and corporate tax shelters.

The teaching of tax law, the practice of tax law, the politics of taxation, and the tax law itself have all undergone a remarkable transformation since Erwin Griswold's casebook first appeared in 1940, and even since I first joined that enterprise in 1976. Let me provide context for my remarks here this afternoon by illustrating some of those changes.

[The Figures referred to appear at the end of this text. These figures illustrate a number of developments since the time of Erwin Griswold's first edition in 1940—the growth in income and payroll taxes, the increasing complexity of the income tax, and trends in federal expenditures including some projections for the future. I also include a picture of the current distribution of wealth in the United States and some international comparisons.]

So what is the status of the nation's tax system today and where should we be heading?

First, I regard the repeal of the estate tax in 2010 by the 2001 Act as a mistake. The estate tax clearly has had problems requiring repair, including the need to increase substantially the exemption, to lower and flatten the rates, and to take more family circumstances into account. And there was a political necessity to expand existing relief—or perhaps even to exempt from taxation—inter-family transfers of closely-held businesses and farms.

But estate tax repeal succeeded because of the powerful political forces aligned against it, not its substantive shortcomings. First, the NFIB—representing small businesses—made estate tax repeal its top legislative priority. Second, the aging baby boom generation is now thinking about its mortality. The marketplace—including the market for legislation—has long been very responsive to the desires and concerns of this large generation.

Third, although the estate tax is imposed only on the wealthiest one to two percent of people who die in any year, a Zogby poll found that the public—by a 71-29% margin—favored its repeal. Some observers dismiss such polls, insisting that two out of every three Americans would be in favor of repealing any tax. But I instead applaud the unflappable optimism of the American people—70% of Americans apparently believe they will be in the richest one or two percent when they die. Steve Forbes's rallying cry for repeal was the best: "No taxation without respiration."

Nevertheless, I think that there are good reasons for retaining a death-time tax on wealth. The first is revenue. Supporters of repeal of the estate tax always point out that it is a minor source of federal revenues, less than 1.5% of the total. (See Figure 2.) But there are sizeable dollars at stake. In 1999, fewer than 50,000 taxable estates contributed \$28 billion to finance the federal government. Estate tax receipts had been projected to grow to about \$40 billion by 2008. This revenue could pay for a reduction in the top individual income tax rate from 39.6 to 33% or a reduction in the corporate income tax rate from 35 to 30% or an exemption of all corporations with assets of \$100 million or less from the corporate income tax. It is not chump change.

Second, estate tax repeal favors the very wealthy, those families who least

need tax relief. (See Figure 6.) About half of all estate tax revenue is collected from the largest ten percent of estates—those valued at more than \$5 million—and in recent years the largest one percent of taxable estates—estates exceeding \$20 million each—have paid more than one-fifth of total estate taxes. Moreover, most of these large estates are composed of liquid assets, not family businesses or farms.

The estate tax has long been an important factor contributing to the progressivity of the federal tax system. Indeed, if repeal of the estate tax succeeds, as some of its proponents believe, in increasing capital accumulations, it will also substantially increase the inequality of wealth.

Third, estate tax repeal could have an important adverse effect for many charities, particularly universities and colleges, hospitals and museums. Typically, more than one-third of estates over \$5 million make charitable bequests, nearly half if the decedent is not married. In 1997, charitable bequests from otherwise taxable estates totaled \$14 billion. More than \$60 billion of assets was held by charitable remainder trusts. Economists have estimated that repeal of the estate tax will reduce charitable bequests by anywhere from 12 to 80%. The economist who offered the lowest estimate also predicted that lifetime gifts to charity would drop by 12% if the estate tax is repealed.

Even if the 2001 Act's repeal of the estate tax actually takes effect, there will be pressure for its reinstatement. The long-term federal budget picture is not rosy. When the baby boom generation retires, financial pressures on Medicare, Medicaid and Social Security will all escalate. (See Figures 9, 10 and 11.) Large tax-free bequests will be a fat target for a Congress looking for money. Proposals linking taxation of large bequests to popular spending plans—to help fund long-term care for the elderly, for example—will be hard to defeat. Moreover, alternatives are available to Congress, which might produce almost as much revenue as reinstating the estate tax. One choice would be to tax recipients of large bequests with an accessions tax, a tax studied by the American Law Institute in the 1960s but largely forgotten since. Even an inheritance tax may prove politically more popular than the disappearing “death tax.” Or, Congress might simply decide to include large bequests in the recipients' income. I would wager that some tax on large wealth transfers will reappear.

Looking forward beyond the next decade, even the payroll tax—the most popular federal tax—faces challenges. Today, for most families, this is the most burdensome tax they pay. (See Figure 8.) There is little protest because the public both knows and likes what the tax pays for, and because the employers' share is hidden to employees. But the aging of the population portends new pressures to raise these taxes, pressures which should be resisted. When the Presidents' Commission on Social Security released its final report at the end of 2001, it failed to agree on a solution—despite a membership which had been chosen for their like-minded views. The Commission offered three alternative approaches to the shortfall between Social Security's finances and its promises of benefits. All three alternatives had one thing in common: a large infusion of funds into the Social Security Trust Fund from general federal revenues.

Not only is the population aging, but increasing life expectancies have made persons age 80 and older the fastest growing age group in America. (See Figure 10.) Anticipated demographic changes now imply an average annual trust fund deficit of more than 2% of covered wages over the next 75-year period—the lifetime perspective over which Social Security finances have typically been measured. The estimated gap between benefits and taxes increases each year as years of trust fund surpluses are replaced with years of deficit, so that if no changes are made, it will take about a 5.5% tax rate hike to cover the gap 50 years from now. Probably the easiest way to comprehend the magnitude of the forthcoming demographic changes is this: In 1940 there were 11 workers for each retiree. Today there are about 3.3. By 2030 there will be only 2 workers per recipient. Thus, if current benefits were financed only from current taxes and if 3 workers today pay 33 cents for each dollar of benefits, 50 cents would be required from each of the 2 workers to fund a dollar of benefits. Or, if taxes are not increased, benefits would have to be cut by one-third.

Unfortunately, projections of Medicare finances are even more dire than those for Social Security. And health cost projections assume the relatively benign increases of recent years, not the accelerating costs of recent months. State finances are also threatened by the aging of the population since most spending on long-term care for the elderly now comes from Medicaid.

To date, most of the political debate has been focused on whether to institute individual retirement accounts. This is an important debate. Tax-favored asset accumulation devices enjoy wide, growing, bipartisan support. The movement for universal individual accounts within the social security system could create an infrastructure for widespread holding and building of financial wealth. Facilitating wealth accumulation for poorer and middle class families should be a national priority. This could prove to be one of the most significant tax and economic policy developments in decades.

But as the President's Commission learned, individual accounts alone will not solve the Social Security financing gap. Some infusion of general revenue seems likely. And if the alternative is an increase in payroll taxes, turning to general revenues also seems right.

But the linchpin of our system for raising general revenues—the income tax—which has served as the mainstay of federal finance for the past 60 years has been losing public and political support.

During the past 25 years the income tax has fallen into disrepute and disfavor. A substantial part of my recent book on the income tax endeavors to explain why this has happened, a story I will not repeat here. But the key fact is this—from the period immediately after the Second World War until 1972, the American people viewed the income tax as the fairest tax in the nation. Since 1980, they have consistently viewed it as the least fair. In the presidential campaign of 1996—for the first time since the enactment of the Sixteenth Amendment in 1913—important presidential candidates made serious calls to repeal the income tax. And the exit polls favoring a flat tax showed far more popular approval than was revealed by simply looking at the votes for Steve Forbes, its chief propo-

nent.

Although the overall level of federal taxes is now at a post-World War II high, income taxes for many middle class families have been reduced by targeted tax cuts. Those tax cuts, along with more promised by the 2001 Act, coupled with the political and press focus on forthcoming financial troubles with Social Security and Medicare, have kept the public clamor for tax reform at bay. Nevertheless, a recent poll revealed that nearly half of the American people favor changing to a “completely different” tax system.

And they have a point. Substantively, the income tax is a mess. Taxpayers at every income level must confront extraordinary complexity. In 1940, the instructions to the Form 1040 were about 4 pages long. By 1976, they had expanded to 48 pages. This year the instruction booklet is 117 pages long. The Form 1040 has 11 schedules and 20 additional worksheets.

As of May 2000, the Code contained about 700 provisions affecting individuals and more than 1500 provisions affecting businesses, totaling 1.4 million words, making the tax law more than 6 times larger than *War and Peace* and considerably harder to parse. The regulations contained another eight million words, spanning almost 20,000 pages. (See Figure 4.) During calendar year 2000, the IRS published 60 Treasury Decisions, 45 sets of Proposed Regulations, 58 Revenue Rulings, 49 Revenue Procedures, 64 Notices, 100 Announcements, 2400 Private Letter Rulings and Technical Advice Memoranda, 10 Actions on Decisions, 240 Field Service Advice documents, and a partridge in a pear tree.

In the past decade the President and Congress have used the income tax the way my mother employed chicken soup: as a magic elixir to solve all the nation’s economic and social difficulties. If the nation has a problem in access to education, child care affordability, health insurance coverage, or financing of long-term care, to name just a few, an income tax deduction or credit is the answer.

Tax legislation during the 1990s completed the unraveling of the 1986 Tax Reform Act, which had promised, but failed to deliver, a broad-based, low-rate, fairer and simpler income tax. The bipartisan coalition that enacted income tax reforms in the 1980s has come unglued. Republican supply-siders and deregulators, determined to lower tax rates and eliminate tax incentives by which government channels private investments and spending, and traditional democratic tax reformers, interested in taxing all income alike, have both become endangered species. Republicans in the Congress have never seen a tax cut they won’t embrace, and Democrats now view income tax benefits as the way to achieve domestic policy goals blocked by political barriers or legal limitations on additional spending.

Senator William Roth, the former Chairman of the Senate Finance Committee, added a new wrinkle to the tax law in 1997 by naming the “Roth IRA” after himself. Ways and Means committee chairman Bill Archer blessed us with the “Archer MSA.” If members of Congress all believe they can attach their names to a new tax break, they might add 535 new items each year.

Despite its complexity, the bipartisan congressional strategy to spend money on social programs through targeted tax cuts seems to please the public. But trying to rectify the nation's social and economic problems through income tax breaks fails to solve the problems being addressed. For example, this nation—contrary to the practice of other industrialized nations, which have universal health coverage and spend far less on health care than we do—relies on tax advantages for employers and employees as its main mechanism for providing health insurance coverage to working Americans. The result: our health care costs are the highest in the world and about 45 million Americans are uninsured. Placing so much reliance on the tax law to produce adequate health insurance has been the Titanic of 20th Century American domestic policy. And Congress seems destined to repeat that mistake by enacting a new tax break for long-term care.

Even the questions an income tax *must* answer have become more difficult given changes in the economy, technology and how business is now conducted. The shift from an economy reliant predominately on manufacturing to a service economy spurred by innovative technology, along with the increasing importance of intangibles in the production of income, has resulted, for example, in a worldwide struggle over how to resolve income tax transfer pricing issues and also has put new pressure on the age-old question whether an expenditure is currently deductible or must be capitalized. The capitalization question has never been an easy issue for the income tax. Even in 1940 Erwin Griswold's casebook contained the classic case of *Welch v. Helvering*, one of the most frequently cited income tax cases—the judicial fountainhead of the capitalization-deduction question. Let me remind you of the guidance Justice Cardozo gave on this pervasive question.

First, Justice Cardozo tells us that the word “ordinary” in section 162 should be read in its natural and common meaning. This is a curious assertion since just one paragraph earlier had the Court read the word “necessary” in section 162's phrase “ordinary and necessary” in anything but its natural and common meaning, concluding that “necessary” does not mean “necessary,” but rather only “appropriate and helpful.” Next, without further ado, Justice Cardozo announces that Mr. Welch's payment of his former company's debts is not “ordinary,” rather, he says, “it is ‘in a high degree extraordinary.’” I never have believed that about Mr. Welch's payments. But, in any event, the Court here experiences a Little Bo Peep moment, telling us first that the payment is not “ordinary,” then that it is “extraordinary.” Little Bo Peep not only “lost her sheep,” but “she doesn't know where to find them.”

Then Justice Cardozo comes to the punch line: “Here, indeed,” the critical paragraph begins. I always warn my students about sentences that begin “Here, indeed.” Indeed, I am wary of sentences merely beginning with “indeed.” But when a court says “here, indeed,” watch out. “The decisive distinctions” Justice Cardozo continues, “are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone.” Taxpayers and the government have been struggling in vain ever since.

Justice Cardozo concludes, “[t]he standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.” Now really; section 162 of the Internal Revenue Code not a “rule of law.” And we have been blaming the *INDOPCO* decision for all of today’s problems.

The problem of capitalization is as old as the income tax. And while old problems have worsened, new problems have emerged. Probably the most important are due to the internationalization of the world economy. We have seen a dramatic increase in flows of both direct and portfolio investments into and out of the United States in recent years. Foreign trade is increasingly important, as are international business and investment activities. Tax-favorable foreign financial centers and global trading have become commonplace. Individuals have also increased their foreign business activities. These developments, along with innovations in ways of doing business, especially innovative financial instruments, pose striking new challenges for taxation, especially income taxation. Elsewhere I have urged a fundamental reexamination of U.S. international income tax policies. No one can doubt the necessity of this task. Without it, the taxation of international income may well completely unravel.

The Clinton Administration insisted that the greatest threat to the income tax is from corporate tax shelters. So far, other than the recent IRS announcement potentially waiving penalties, the Bush administration has had little to say on this subject. I have long been convinced that a stable solution to the corporate tax shelter problem will require greater conformity between book and tax accounting for large publicly traded companies. Only then will economically unsound tax-motivated transactions reduce the company’s earnings to shareholders. The Enron debacle has strengthened my conviction.

By 1986, when Congress eliminated safe-harbor leasing, corporate attitudes toward the income tax had changed. Many corporate managers had come to regard their tax departments as another potential profit center. They could increase returns to shareholders by producing a better product, selling more goods or services, or by saving taxes. Often tax saving was easier.

The 1986 Tax Reform Act halted the widespread use of tax shelters by individuals. But since then corporate tax shelters and our two-tier system of tax enforcement have eaten away at both the federal fisc and the public’s sense of tax fairness. No matter what the data show about the amount of income taxes being paid by high income taxpayers or about the relationship of corporate taxes to corporate profits, Joe Sixpack no longer believes he is getting a fair shake. Joe believes that wealthy people and large corporations have tax advisers—lawyers, accountants, investment bankers, magicians and alchemists—to help them arrange their affairs to duck the taxes they should be paying, to avoid their fair share of the tax burden.

Americans now regard the income tax both as too complicated and unfair. Not only has this phenomenon diminished popular support for the income tax, it also threatens income tax compliance. Lou Harris, among others, has reported a growing sentiment—especially among the young—that there is nothing wrong

with tax cheating. In one episode of the 1970s comedy, *All in the Family*, Archie told his wife and son-in-law that he had no intention of paying tax on his income from a second job for which he was paid in cash. Archie said, "All those rich guys have their tax shelters and this is my tax shelter." Twenty-five years later, *Forbes* magazine asked "Are you a chump?" for paying the taxes you owe. This Archie Bunker attitude poses a real threat to the income tax.

Congress creates the complexities in the tax law, often providing convoluted or inadequate statutory guidance—then blames the IRS for being unable to cope. More power and more discretion devolves to the IRS and often to lower levels within the IRS. As Congress has delegated more power to the IRS, it simultaneously introduced new penalties into the law in an effort to change the odds of the tax planning lottery.

In 1998, Congress enacted the IRS Restructuring and Reform Act changing the governance and many operations of the IRS. IRS officials now talk of a customer-friendly culture at the IRS. The Treasury Department designed customer satisfaction surveys for people who undergo IRS audits or collection activities. (Your tax dollars at work!) The architects of the IRS restructuring legislation and the IRS Commissioner all agree that the IRS must become a modern user-friendly financial services institution. And improvements have occurred. A recent University of Michigan survey even showed that people now prefer dealing with the IRS than the airlines. Talk about damning by faint praise.

While I am a great fan of Charles Rossotti and his efforts to reorganize the IRS, I remain wary when people talk about a customer-friendly IRS. I will become a werewolf before I change from a taxpayer into a customer of the IRS. Luckily, the IRS computers remain too creaky to call us at dinner offering some new taxpaying option. To think that the IRS can become a modern financial services institution without a major overhaul of the tax law it administers, is to believe that you can turn a Winnebago around without taking it out of its garage. When Congress promises to make the IRS customer friendly, I am reminded of Emerson's comment about an acquaintance: "The louder he talked of his honor, the faster we counted our spoons."

The fundamental problem is that the IRS is being asked to do too much. A major simplification of the nation's tax law is necessary. We need a major overhaul of our nation's tax system. Here is one idea: A consensus seems to have emerged for repeal of the alternative minimum tax, because of the 2001 Act's failure to avoid the massive increase in the number of taxpayers the AMT will affect when the Act's rate reductions are fully phased in. But we should instead repeal the regular tax. If the 2001 Act does not sunset, more revenue would be produced in 2008 by the AMT standing alone than by the regular tax. If the regular tax were then repealed, 40 million fewer families would have to file tax returns, eliminating about one-third of all filers from the rolls. People who applauded the 1986 Act's approach to tax reform—lower rates and a broader tax base—should stop complaining about the AMT and start campaigning for repeal of the regular tax.

I would go even further. The vast majority of American families should not

need to deal with the IRS at all. In the current debate, only the proponents of a national sales tax seem committed to this result. Everyone else—the flat-taxers, the income tax reformers, those who favor progressive consumption taxes—would fail to remove the IRS from the lives of average Americans.

Given Congress's propensity for enacting targeted tax breaks, it is hard to believe that a flat tax—which still would require individuals to file tax returns—would stay pure, flat, or simple for very long. The political allure of tax breaks for specific expenditures or investments is catnip to both Congress and the White House. And the flat tax's treatment of exports and imports makes it an anathema to American businesses.

The sales tax proponents have an important advantage. They are correct that the vast majority of American families should not have to deal with the IRS at all. They have labeled their proposal the "fair tax" and are spending tens of millions of dollars to build grass-roots public support. The rub, however, is that complete replacement of the income tax with a national sales tax would provide a large tax reduction for the country's wealthiest people.

The current income tax is a horrible mess. But, in the course of radically restructuring our tax system, we should not enact a massive tax reduction for the country's wealthy people, those who least need such relief. The tax system can, and should, be fixed without such a shift in the nation's tax burdens.

In discovering how we should move forward, we can usefully look back to our nation's tax history. As I have urged elsewhere, we should return the income tax to its pre-World War II status—not exactly to Erwin Griswold's beloved 1939 Code—but to a relatively low-rate tax on a thin slice of the wealthiest Americans. Enacting a value-added tax (VAT) of 10 to 15% would finance an income tax exemption of up to \$100,000 and would allow a vastly simpler income tax at a 25% rate to be applied to incomes over \$100,000 (see Figures 12 and 13), without either losing revenue or dramatically shifting the tax burden toward middle and lower income families. The VAT, which is commonly used throughout the world, would operate much like a national sales tax, but would be much easier to administer and far more difficult to evade. Because a VAT has long been considered dangerous to politicians who advocate it, another name may be necessary politically—call it a goods and services tax, a business sales tax, or, simply, a consumption tax. The earned income tax credit would have to be replaced with a direct adjustment to take-home pay through withholding credits, and bringing the states into conformity with the new federal system would pose a major challenge.

But the kind of change I am advocating here would eliminate more than 110 million of the 135 million income tax returns that currently are filed each year, and would allow substantial simplification of the slimmed-down income tax that would remain. Enacting a VAT would also allow us to whittle the corporate income tax down to a 25% rate, making the United States one of the most attractive nations for corporate investment in the world. As sales tax proponents are fond of saying, for the more than 150 million people from whom no income tax would be required, April 15 would be just another spring day.

But it is difficult to see how our current political process will achieve this kind of restructuring of the nation's tax law. How do we move forward intelligently when in our political discourse ideology trumps ideas and demagoguery drowns out debate? Reforming the tax law must be accompanied by reforms in the process for making that law.

As we think about the future of our nation's tax system we must remember its central role in America's political life. It is difficult to be optimistic about the political future of our tax system when our political system is so undermined by the money raising system for financing political campaigns. Jesse Unruh, one of California's premier politicians, was fond of saying, "money is the mother's milk of politics." The congressional leadership and members of the House Ways and Means and Senate Finance Committees are routinely showered with motherloads of milk.

As a nice counterpoint to the vast sums of money contributed to members of Congress, let me close with the following comments concerning the retirement of George Lefcoe, my former U.S.C. law school colleague, from the Los Angeles County Regional Planning Commission:

He said that a mistake might have been that he retired before, and not after, Christmas. "I really missed the cards from engineers I never met, the wine and cheese from development companies I never heard of and, especially, the Honey-baked ham from, of all places, Forest Lawn (a well-known Los Angeles mortuary and cemetery), even though the company was never an applicant before the commission when I was there," Lefcoe said. "But because I miss them is why I think it was a good idea I resigned," he added, "I do not think it is wise to stay in public office for too long a time."

Lefcoe used the ham from Forest Lawn as an illustration: "My first Christmas as a Commissioner—when I received the ham—I tried to return it at once, though for the record, I did not because no one at Forest Lawn seemed authorized to accept hams, apparently not even for burial. My guess is that no one of the many public servants who received the hams ever had tried to return it," said Lefcoe.

"When I received another ham the next Christmas, I gave it to a worthy charity," Lefcoe recalled. "The next year, some worthy friends were having a party, so I gave it to them. The next year I had a party and we enjoyed the ham."

"In the fifth year, about the 10th of December," said Lefcoe, "I began wondering, where is my ham? Why is it late?"

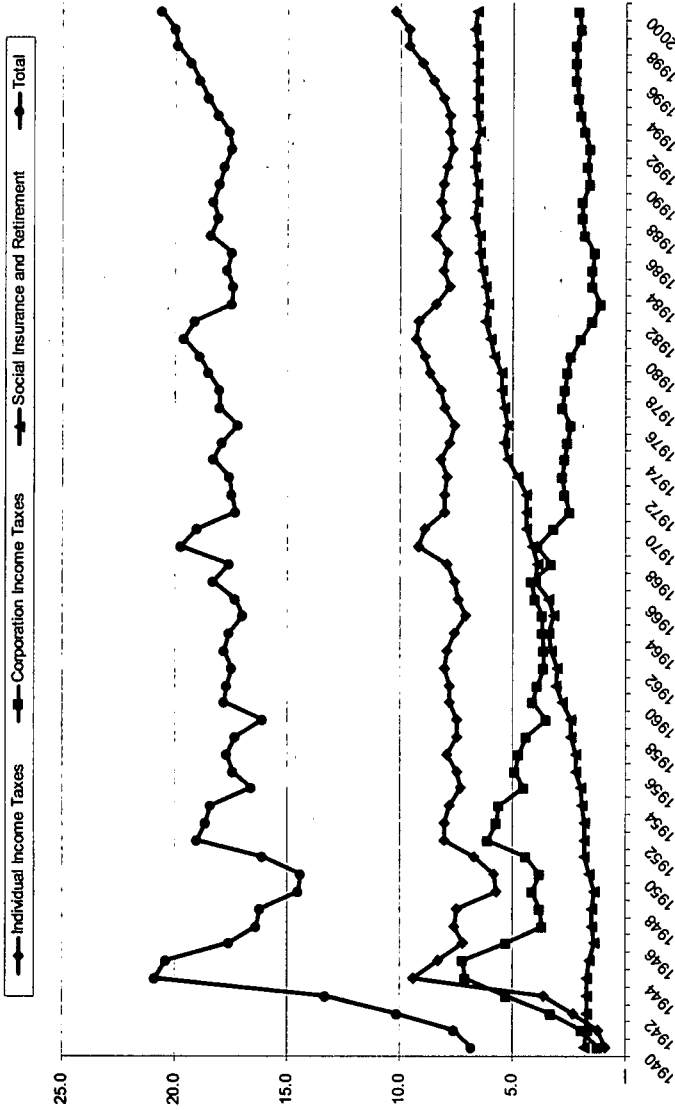
Lefcoe sighed and laughed. "So much for the seduction of public officials. It was then I thought it was time to retire though it took me two more hams and three years to finally do it."

Now, there's an example more members of Congress should follow.

Thank you.

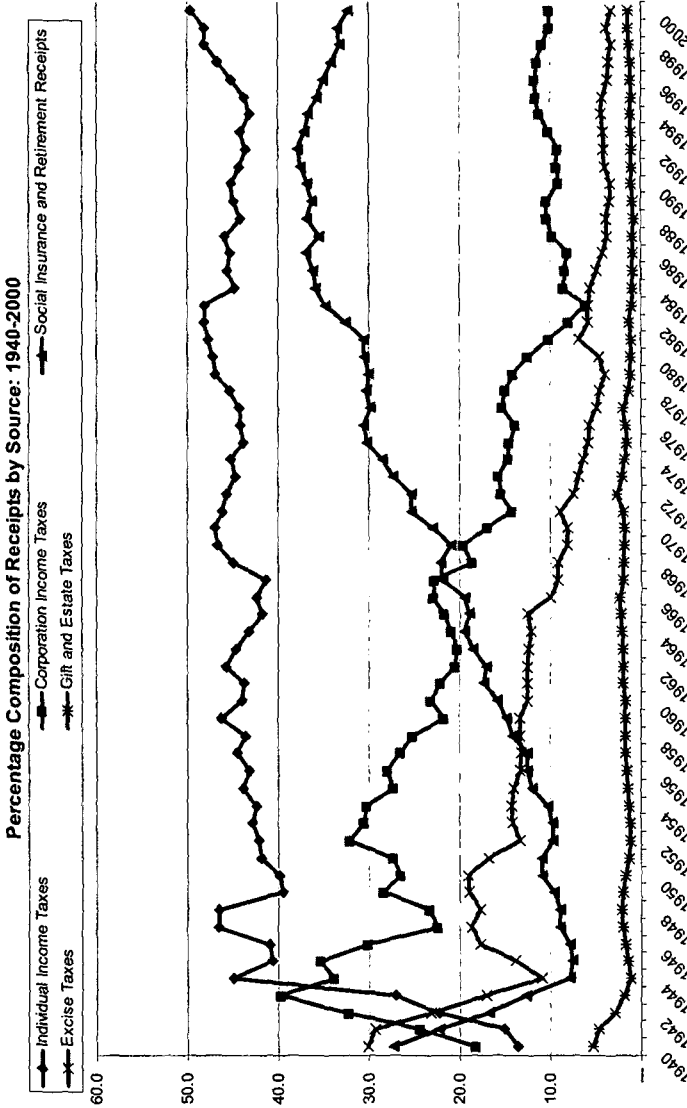
Figure 1

Receipts by Source as Percentage of GDP: 1940-2000



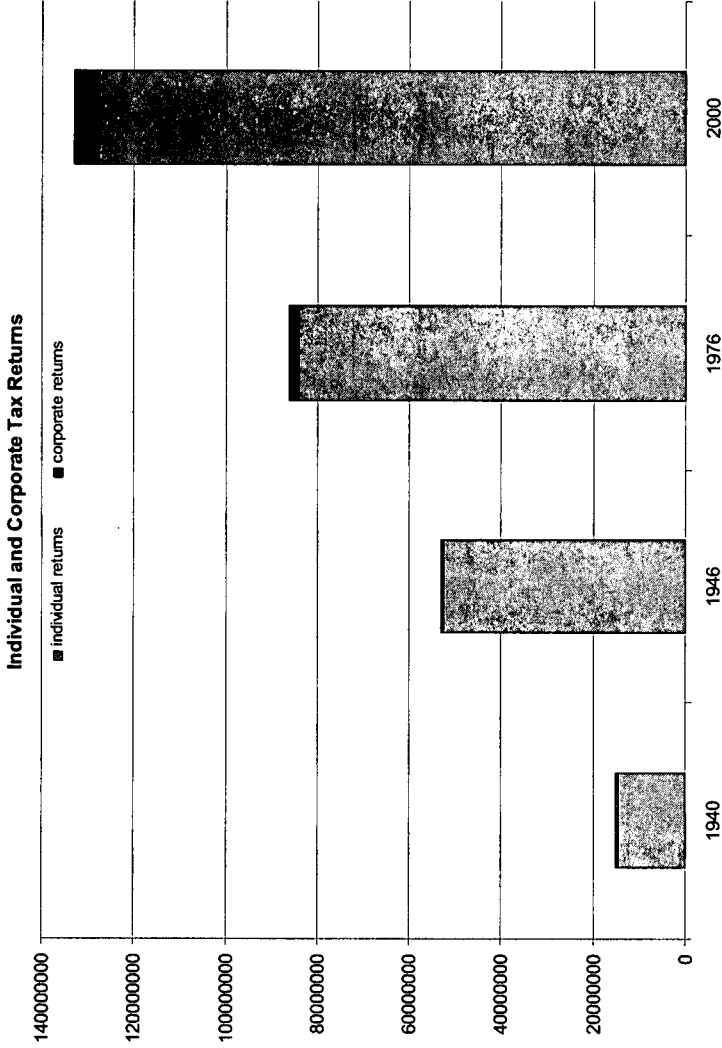
Source: Budget of the United States Government, Fiscal Year 2002, Historical Tables (2001), Table 2.3.

Figure 2



Source: Budget of the United States Government, Fiscal Year 2002, Historical Tables (2001), Tables 2.1, 2.2, 2.5.

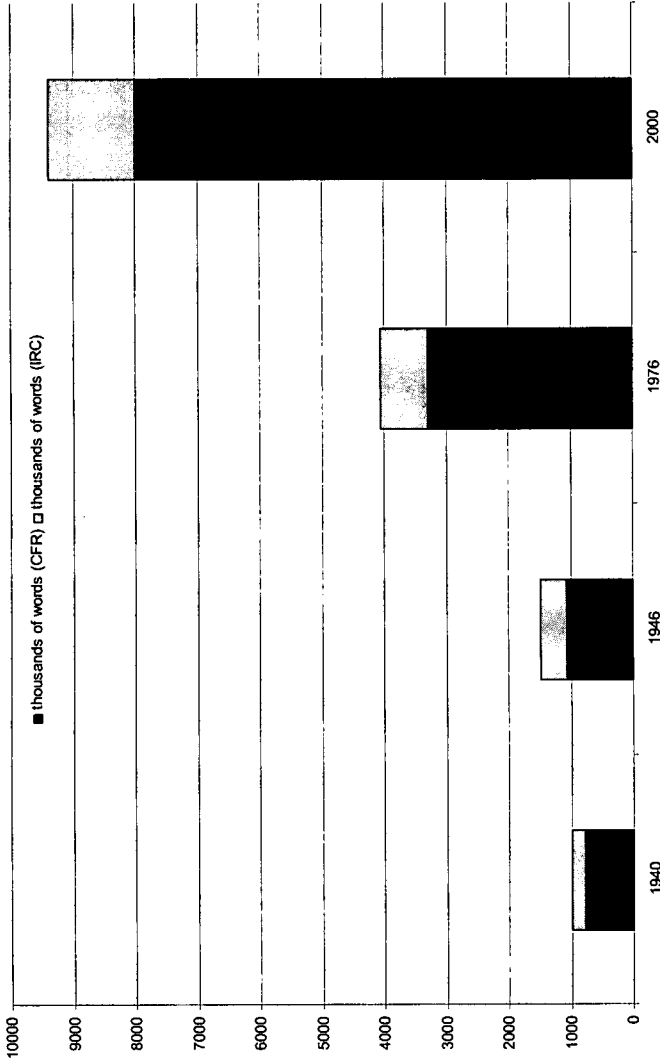
Figure 3



Sources: 1940 and 1946: Statistical Abstract of the United States (1956); 1976: IRS Statistics of Income Bulletin (Summer 2000); 2000: Internal Revenue Service Databook (2000).

Figure 4

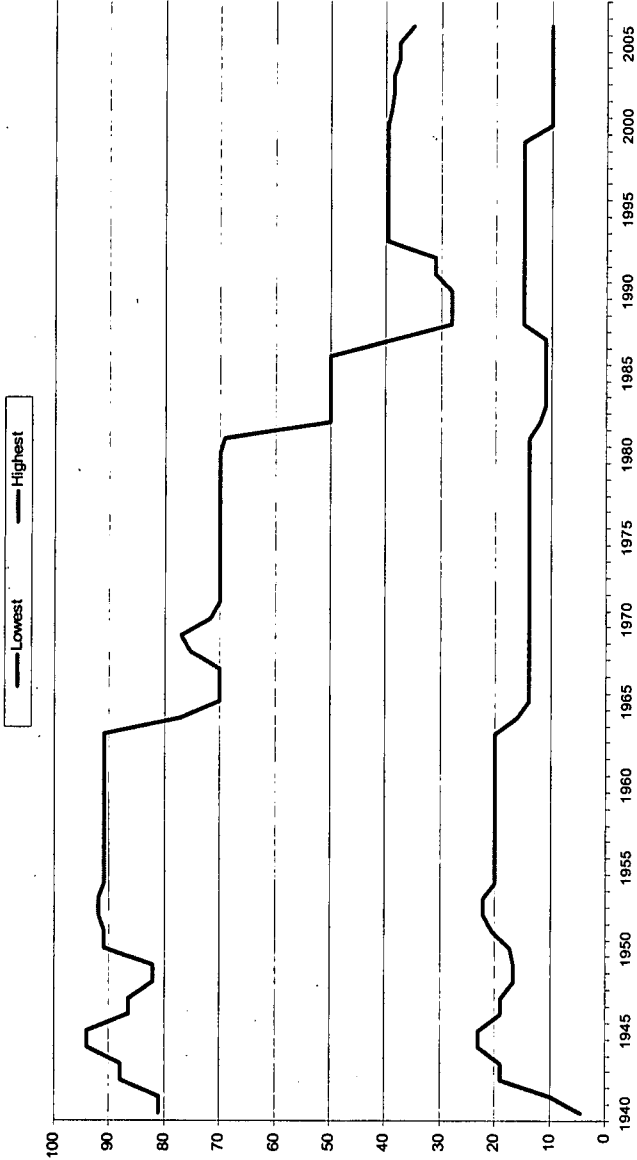
Approximate Words in IRC and Regulations



Author's estimates for 1940 and 1946 are derived from random samples of pages found in the *United States Code* and the *Code of Federal Regulations*. Numbers for 1976 are taken from Tax Foundation, *Growth of Numbers of Words in the Internal Revenue Code Selected Years, 1955-2000*, available at <http://www.taxfoundation.org/compliance/estimonytable1.html>. Numbers for 2000 are taken from Joint Committee on Taxation, *Simplification Report, Study of the Overall State of the Federal Tax System*, at 4.

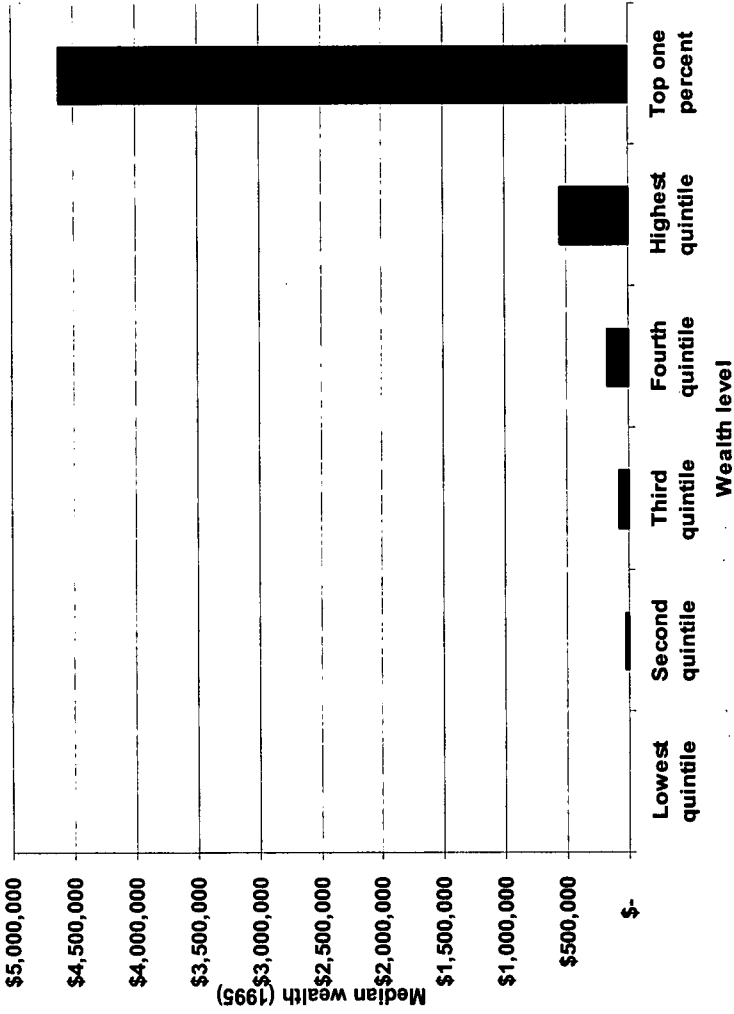
Figure 5

U.S. Income Tax Rates: Lowest and Highest, 1940-2005



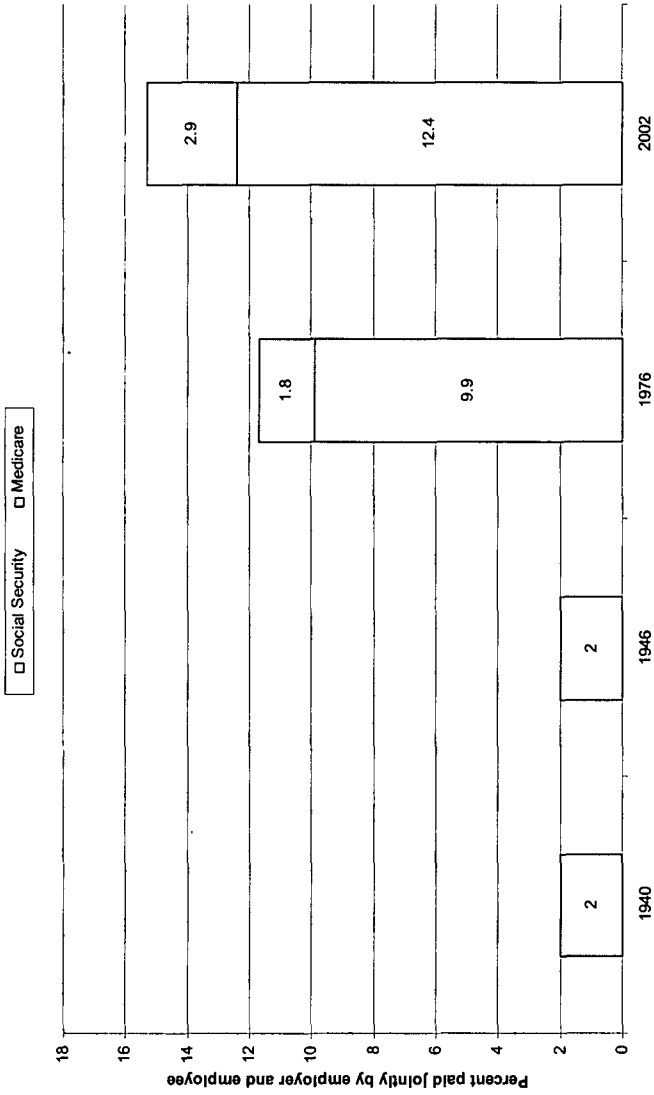
Source: JOSEPH PECHMAN, FEDERAL TAX POLICY (Brookings Inst. 5th ed. 1987) Table A-1, updated with current IRS publications. Figures for 2002-2006 are based on 2001 law.

Figure 6
Wealth distribution



SOURCE: BRUCE ACKERMAN & ANNE ALSTOTT, *The Stakeholder Society*, 225, TABLE 3 (YALE UNIV. PRESS 1999).

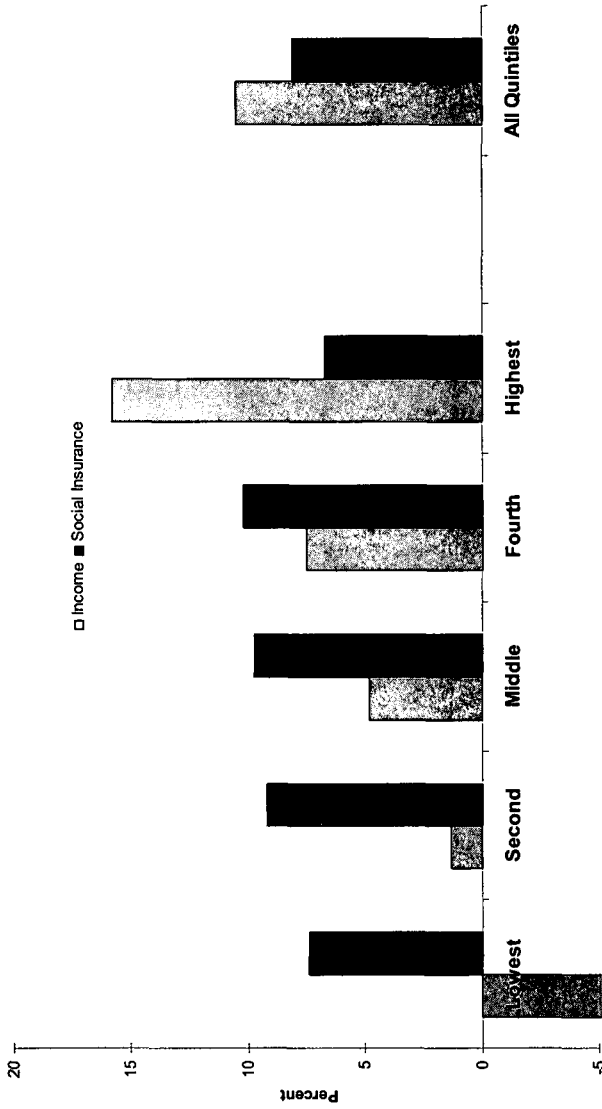
Figure 7
U.S. Payroll Tax Rates: Selected Years



Source: KEATING & EDMONDS, U.S. BY THE NUMBERS, at 11 (Capital Books, 2000).

Figure 8

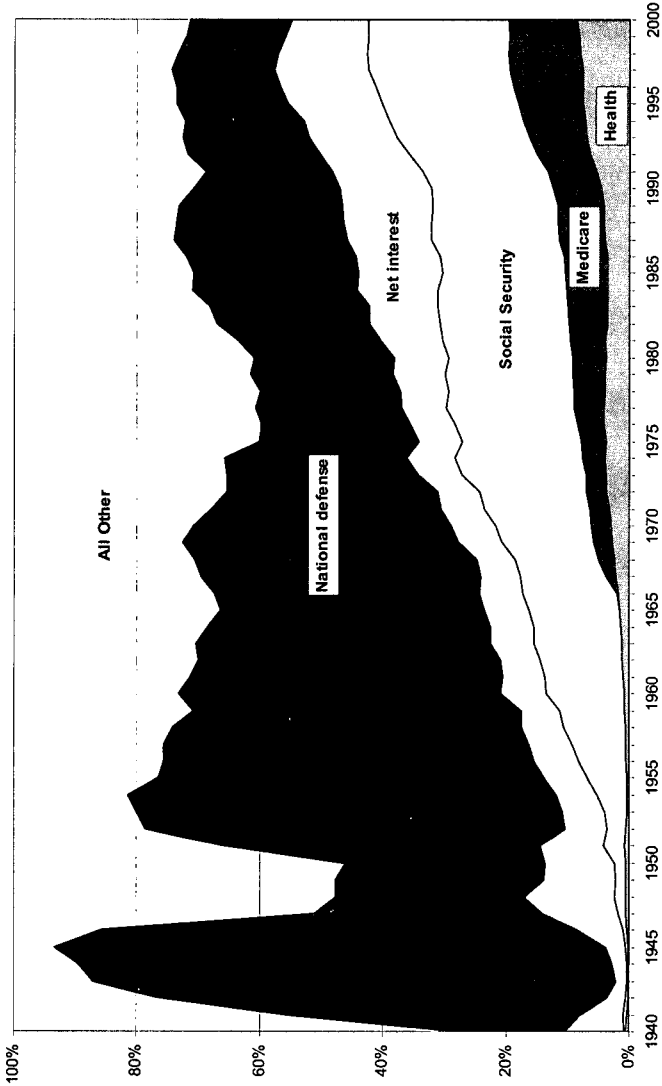
Effective Federal Individual Income and Social Insurance Tax Rates, by Income Quintile, Using Comprehensive Household Income (1997)



Source: Congressional Budget Office, Effective Federal Tax Rates, 1979-1997 Table G-1a (CBO 2001).

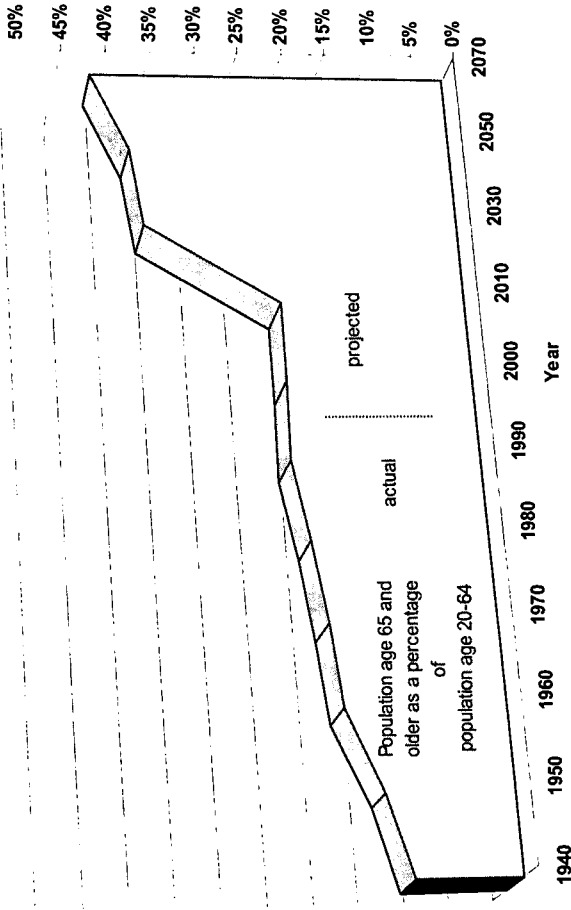
Figure 9

Federal Expenditures as a Percentage of Total Budget



Source: Budget of the United States Government, Fiscal Year 2002: Historical Tables (2001), Table 3.1. EUGENE STEUERLE, ET AL., THE GOVERNMENT WE DESERVE: RESPONSIVE DEMOCRACY AND CHANGING EXPECTATIONS, Figure 4.6 (Urban Inst. Press 1999).

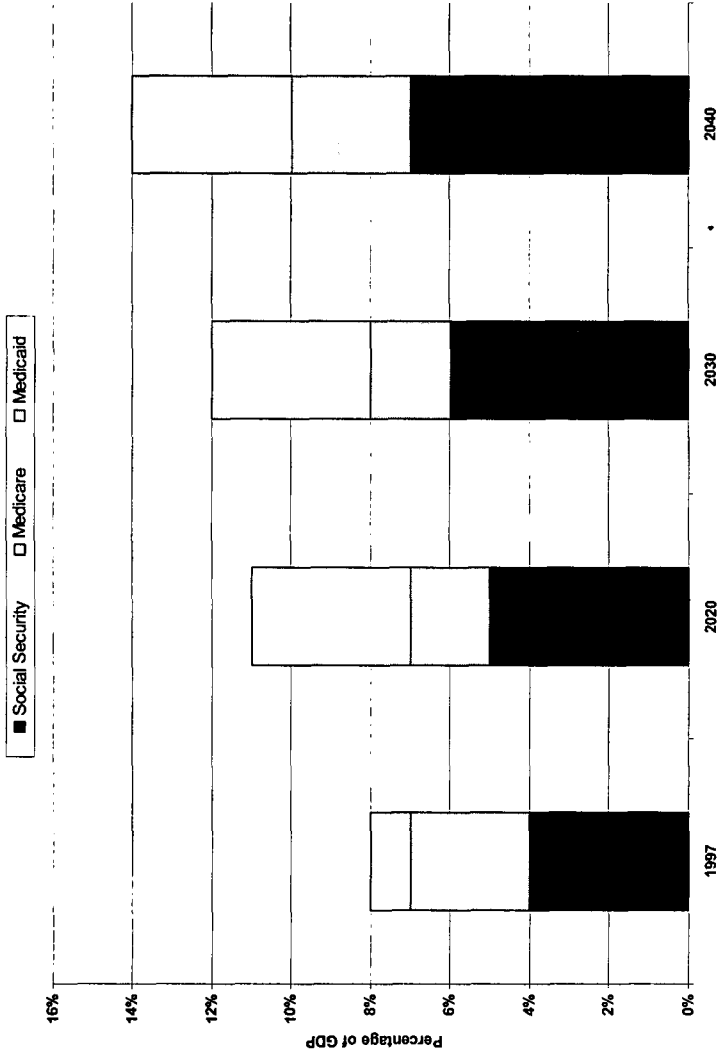
Figure 10
65-plus dependency ratio



Source: Authors' calculations based on data from 1998 Economic Report of the President, Table B-34 and Congressional Budget Office, *Long-Term Budgetary Pressures and Policy Options* (May 1998) Table 1-1.

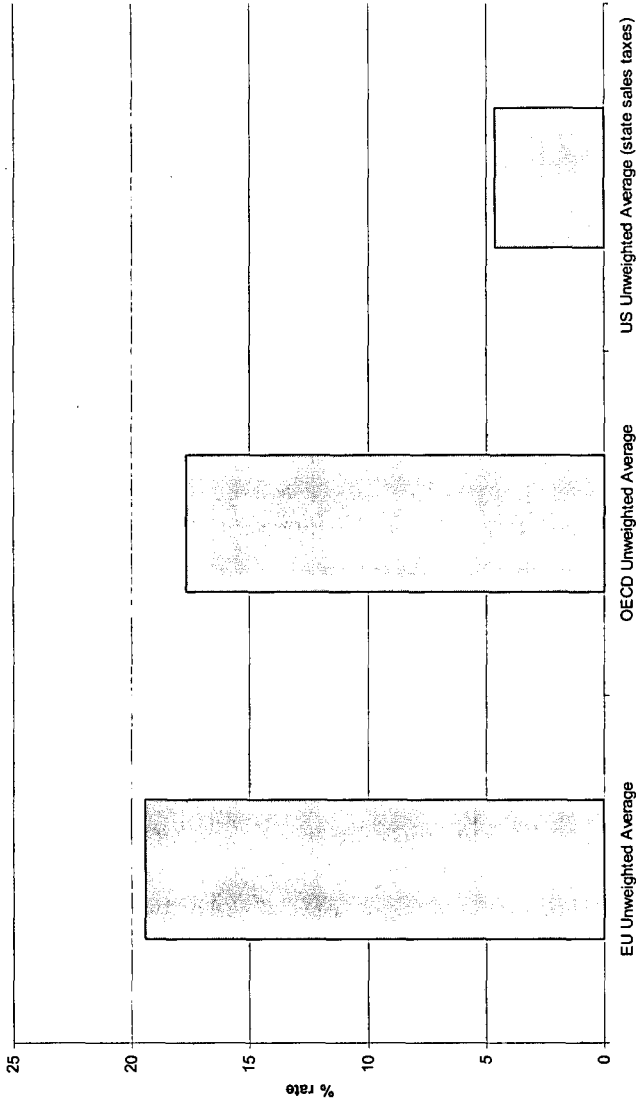
Figure 11

Projections of federal expenditures on Social Security, Medicare, and Medicaid



Source: Congressional Budget Office, *Long-Term Budgetary Pressures and Policy Options* (May 1998) Table 2-1.

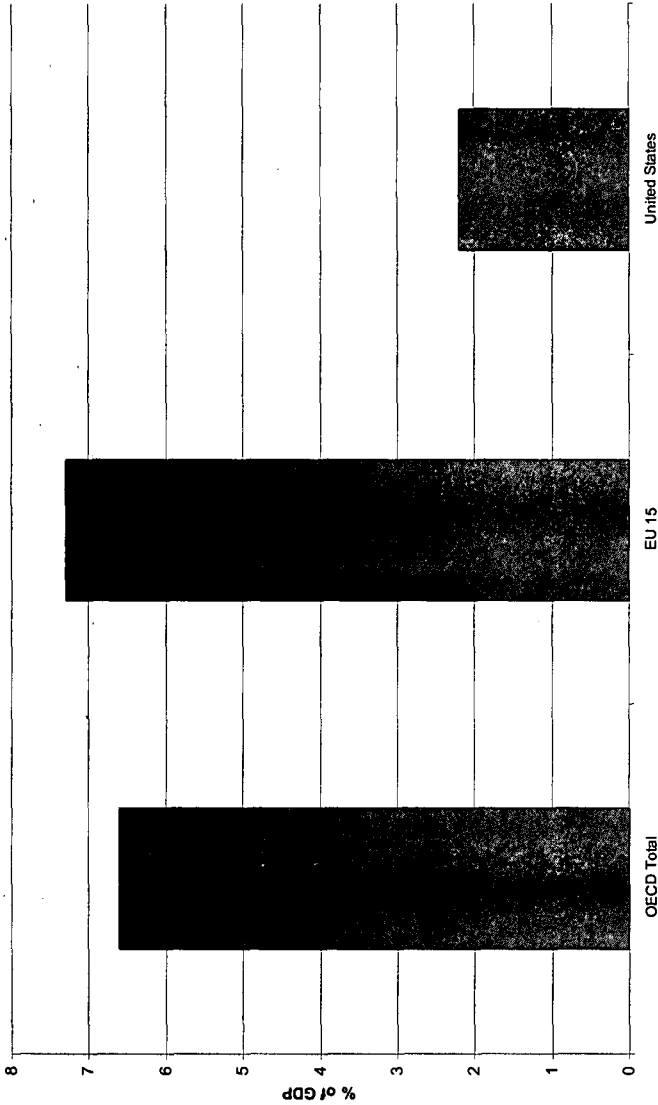
Figure 12
Consumption (VAT) Tax Rates in the EU, OECD members, and US: 2000
(unweighted rate averages)



Source: Consumption Tax Trends 2001 (OECD) Table 3.5; U.S. computations based on data from <http://salestaxinstitute.com> (visited 1/10/2002).

Figure 13

Consumption Taxes (including VAT) as Percentage of GDP: 1999



Source: Consumption Tax Trends 2001 (OECD) Table 3.1