[Excerpt from Alvin C. Warren, Jr., *Three Versions of Tax Reform*, Wm. & Mary L. Rev. 157 (1997)]

~~lectual foundations of tax reform, the use of those ideas in the political process, and the level of understanding of the ideas by the tax paying public.~~

I. IMPROVING AN EXISTING TAX BASE

The first version of tax reform that I want to explore is the regular work of improving an existing tax base. Given the relative importance of income taxation in the United States, it is not surprising that "tax reform" in the U.S. generally has meant refinement and improvement of the income tax.

The seminal American formulation of the concept of income for these purposes is the celebrated definition articulated by the University of Chicago economist Henry Simons in the 1930s.[7] Given the centrality of what has come to be called the Haig-Simons definition of income to our first version of tax reform, it is worth quoting the concept in detail:

> Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to "wealth" at the end of the period and then subtracting "wealth" at the beginning. The *sine qua non* of income is *gain*, as our courts have recognized in their more lucid moments—and gain *to* someone during a specified time interval.[8]

The key idea in this quite abstract formulation is that gains or increases in wealth, from whatever source, constitute the ideal personal income tax base, whether those gains are saved or spent on current consumption. This idea is not, however, directly translatable into an operational income tax, which has always

7. *See* Richard A. Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44, 47 n.7 (1967) (indicating that an earlier version of the concept was proposed by George Schanz in *Der Einkommensbegriff und die Einkommensteuergesetze*, 13 FINANZ ARCHIV 1 (1896) and introduced into American discussion in THE FEDERAL INCOME TAX (R. Haig ed., 1921)).

8. HENRY C. SIMONS, PERSONAL INCOME TAXATION 50 (1938).

used transactions, such as the receipt of salary or sale of assets, rather than mere changes in value, to trigger taxation.[9]

The Haig-Simons definition was thus but the beginning for our first version of tax reform. The concept had to be translated into operational terms to deal with questions such as the following:

(1) Should fringe benefits be taxed differently from salary under an income tax?

(2) Should capital gains be taxed at a lower rate than other income?

(3) How should capital cost recovery for machinery and equipment be designed under an income tax?

(4) How should the income tax burden be affected by marital or family status?

These and hundreds of similar questions have been addressed in a remarkable outpouring of writing on income tax policy since the end of the Second World War. One of the notable features of this literature is that it has been a joint enterprise of economists and lawyers in the government, in the universities, and in private practice. For example, the House Ways and Means Committee published an important compendium of papers on "broadening the tax base" in 1959.[10] Academic lawyers and economists debated the merits of a "comprehensive tax base" in the 1960s.[11] Important Treasury Department studies of tax reform were published in 1969,[12] 1977,[13] and 1984.[14] The American Bar Association Section of Taxation published an evaluation of the proposed model "comprehensive income tax" in 1979.[15] And

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9. *See* I.R.C. § 61 (West Supp. 1997) (defining gross income in terms of transactions that produce the income).

10. *See* SUBCOMM. ON TAX POLICY, JOINT COMM. ON THE ECON. REPORT, 84TH CONG., FED. TAX POLICY FOR ECON. GROWTH AND STABILITY, (Joint Comm. Print 1955) (analyzing the focus of tax policies and the impact of taxation on income and consumption).

11. *See, e.g.*, BORIS I. BITTKER ET AL., A COMPREHENSIVE INCOME TAX BASE? A DEBATE (1968).

12. *See* HOUSE COMM. ON WAYS & MEANS & SENATE COMM. ON FIN., 91ST CONG., TAX REFORM STUDIES AND PROPOSALS—U.S. TREASURY DEP'T pts. 1-4 (Comm. Print 1969).

13. *See* U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM (1977).

14. *See* U.S. DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH (1984).

15. *See* Special Comm. on Simplification, ABA, *Evaluation of the Proposed Model*

the Brookings Institution organized a series of joint tax reform conferences for economists and lawyers in the 1970s and 1980s.[16]

As a result of all this intellectual activity, a broad consensus developed among tax policy professionals about how the income tax could be improved, given the assumption that income was to be taxed. The short version of this consensus is that for reasons of fairness, economic efficiency, and ease of administration, the income tax should ideally make as few distinctions as possible among different categories of income and expenditure. According to the consensus, distinctions generally are to be avoided if they treat similarly situated taxpayers differently, if they distort economic decisions, or if they unduly complicate legal rules or business transactions.

The fullest expression of this view was probably the characterization by Harvard Law School Professor Stanley Surrey, then serving as Assistant Secretary of the Treasury for Tax Policy in the Johnson Administration, of deviations from the ideal as "tax expenditures."[17] Surrey's faith in the consensus view was so strong that he thought legislative deviations from that view should be analyzed as the equivalent of tax receipts that had been collected and then spent on tax-favored activities.

~~One result of all this work by tax policy specialists was that whenever political conditions ripened, there were legislative ideas already available for tax reform in the sense of improving the income tax by eliminating distinctions among different kinds of income. One important example was the Tax Reform Act of 1969,[18] which followed Surrey's tenure at Treasury, and which eliminated many tax preferences.~~

Comprehensive Income Tax, 32 TAX LAW. 563 (1979).

16. *See, e.g.*, COMPREHENSIVE INCOME TAXATION (Joseph A. Pechman ed., 1977) (describing methods to broaden the tax base and attempts to lower tax rates); WORLD TAX REFORM: A PROGRESS REPORT (Joseph A. Pechman ed., 1988) (discussing tax reform in other countries and the United States's reaction to such measures).

17. For the most complete development of the concept by its originator, see STANLEY S. SURREY & PAUL R. MCDONALD, TAX EXPENDITURES (1985).

18. Pub. L. No. 91-172, 83 Stat. 487 (1969) (amended 1986).