Is the Tax Law Going to Seed?

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It is a great honor to be invited to speak before this group--and, indeed, to have a lectureship established in my name. I am grateful to those of you who have brought this about, and hope that this may result in a series of lectures which will help to make our tax system more understandable and workable.

Obviously, in preparing this lecture, my first task was to pick an appropriate subject. I might, for example, speak on the subtler aspects of ESOPs, or give a disquisition on some other aspect of the exciting field of deferred compensation, or a disquisition on SLIPS, SLAPS, or SLOPS. Somehow or other, this is not very appealing. It made me think of Wordsworth's words:

> The world is too much with us; late and soon,
> Getting and spending, we lay waste our powers.

So, I thought I would find some topic which is more general, and not too heavy. With this in mind, this lecture undertakes some broad comments on our federal tax law, based on my own experience. In an informal way, I will try to summarize how it has grown, where it is now, and what its future prospects are. My remarks will be without the trappings of deep scholarship. I will often paint with a broad brush, and rely on personal experience. I may jest sometimes, but for the purpose of raising questions.

My first contact with our tax law came more than sixty-three years ago, when, at the age of twenty-five, I became the junior assistant in the Office of the Solicitor General in the Department of Justice in Washington. I had no background whatever in tax law. I never took a course on taxation, for the simple reason that there was no such course when I was a student at the Harvard Law School. The Constitutional Law course did deal in passing with a few questions of state taxation, such as those arising under the due process clause, and under the interstate and foreign commerce clause. There was no reference to the Federal tax law.

Shortly after I started my work in the Solicitor General's Office, I noticed that all of the tax cases were being routed to me. I thought seriously of going to the Solicitor General and telling him that I knew nothing about taxes. However, I soon recognized that the better solution was to go to the library, and learn what I could. This led me to make the novel request that a tax service be provided to me for use in my office. Though this involved much red tape, and several conferences, in due course, the purchase was authorized. Because it was cheaper, I suppose, the service provided was that put out by Prentice-Hall. One consequence of this has been that I have been a Prentice-Hall man throughout my career.

As one of the ancients said, "The times change, and we change with them." Because we change with them, it is sometimes difficult to perceive that there have been changes, even major ones. It does not take much reflection, though, to recall that the world today, is a very different place from what it was in the early days of the federal tax system.

The general federal income tax under the Sixteenth Amendment became effective on March 1, 1913, a few days short of eighty years ago. At the beginning, it was very modest. The normal tax rate was one percent, and the maximum rate of tax was seven percent on income in excess of $500,000. Indeed, the first income tax was a rider added as Section II of the Tariff Act of 1913. During the first World War, tax rates rose steeply for a few years, including an excess profits tax. But this did not last long. The rates soon declined, and the courts became involved in the next decade with a number of overlooked problems, such as the taxation of the income from community property. Other cases which came along in those fairly early days involved the burning question of the validity of waivers of the statute of limitations, taxability

of assigned income (Corliss v. Bowers, 281 U.S. 376 (1930)), how specific a claim for refund must be (United States v. Felt & Tarrant Mfg. Co., 283 U.S. 269 (1931)), and the tax effect of a cancellation of indebtedness (United States v. Kirby Lumber Co., 284 U.S. 1 (1931)). It was fun to work on these cases. There was little in the statute that dealt with them and the approach was on a sort of common law basis.

It is easy to forget the fact that the country was, in those days, a far simpler place than it is today--simpler in economy and simpler in social structure. Since that time the population has doubled and the economy, including the gross national product in current dollars, is about ten times what it was then. Moreover, the expectations of the people have greatly increased. Except for veterans, there were then no "entitlements." The national debt was minimal, and there was no appreciable problem about raising taxes to pay interest on the outstanding bonds. The early 1930s included, of course, the depth of the depression, which was far more serious than our present situation. The Democratic Administration was elected with substantial talk about retrenchment. I was one of those whose salary was cut by ten percent under the third statute enacted in the Roosevelt Administration, which was entitled "An Act to Maintain the Credit of the United States." But this soon changed under the influence of the Keynesians, and we moved into the era of "tax and spend," the generally dominant theme ever since.

There was no television in those days, and radio was still developing. There was no air-conditioning. In the Department of Justice, most of our seniors took off for Maine during the summer, and left us young fellows pretty much in charge. I say "fellows," because there were very few women lawyers then. Major exceptions to this were Mabel Walker Willebrant, who was Assistant Attorney General for the Tax Division in the Coolidge Administration, and Helen Carloss, who was the leading appellate lawyer in the Tax Division, and had great influence on courts of appeals throughout the country. There were no black lawyers in the Department then. Our only contact with persons of African descent was with the elevator operators, and the man who came around once or twice a week to shine shoes. As I recall it, the charge was twenty cents, and we usually gave him a quarter.

The tax law at that time was enacted in full at two-year intervals. The income tax provisions of the Revenue Act of 1932 occupied about seventy-five pages in the large type of the Statutes at Large. However, in the Solicitor General's office, we were always working on cases which had arisen in earlier years. For several years, I think that I was the greatest expert around on the Revenue Act of 1924. I also found that when a stack of papers a foot or so high was put on my desk, it was a case under the excess profits tax provisions of the Wartime Revenue Act of 1917, often involving the so-called "special assessment" provisions under the 1918 statute. This was a sort of automatic discretionary provision for tax relief, and a gold mine for tax lawyers.

Since those halcyon days, many changes have occurred. There were then five lawyers in the Solicitor General's office; now there are twenty-five. This change in size corresponds generally to the number of cases on the Supreme Court's docket. There were about a thousand cases submitted each year in the early 1930s; now there are five thousand. But there are other changes. There were no computers in those days, except for the punched card system, on which IBM was founded. But there was no use for that in the Solicitor General's office. There was no fax, no voice mail, no Xerox. Long-distance telephone calls were subject to delay. Your letter box was not packed with fancy mail-order catalogues and charitable solicitations. All official letters were written on typewriters, and they clattered up and down the hall. Now, we have word processing, with interoffice connections, and typewriters have virtually disappeared. The new word processors are fascinating, and frequently save much time. They are also intimidating to me. I decided a few years ago that I was too old to try to learn how to push all the buttons in the right order.

Through Westlaw and Lexis virtually any decision is instantly available, including a case decided only minutes ago by the Supreme Court. I grew up on Shepard's citations, and still use the various volumes,

hoping that they will not be discontinued. Most of the lawyers in the office, though, use Westlaw or Lexis for searching citations, at considerable expense to the clients.

Why do I mention these well-known facts? The reason is simply that they parallel an enormous development of the tax law over the past sixty years, particularly in the past thirty years. When I started in the tax field, the income tax provisions of the Revenue Act of 1932 appeared in about two hundred sections. There were not many tax lawyers, or, indeed, not many lawyers who knew anything about taxes. About forty lawyers attended the founding meeting of the Tax Section in 1948. Short of litigation, most lawyers felt that this was essentially work for accountants, and thus, from their point of view, a little beneath them. There are now a number of law firms which specialize in taxes, and nearly every firm has a Tax Department, with a sizeable number of tax lawyers.

In the early stages, the accounting firms and individual accountants eagerly sought tax business. In due course, a considerable amount of friction developed between the accountants and the lawyers. For a number of years, I was a member of a committee of the American Bar Association dealing with relations between lawyers and accountants, and we met regularly with a corresponding committee of the American Society of Certified Public Accountants. Under the wise leadership of a former President of the American Bar Association, William J. Jameson, we urged that the accountants and the lawyers should work together, leaving the bookkeeping, auditing, and preparation of tax returns to the accountants, subject to their seeking legal advice from lawyers when a significant legal question arose. After several years of active work, the conference between the lawyers and the accountants disappeared.

There was another important event which occurred about forty years ago, and this was the rise of the influence of a remarkable tax lawyer, Stanley S. Surrey. I first encountered Stanley through an article he wrote just after graduation from the Columbia Law School in 1932. Later, I worked with him at the Treasury, and was much impressed by him. In 1946, when I became Dean of the Harvard Law School, I wanted to bring Stanley to the Law School faculty, but no one on the Appointments Committee knew him, and I was not able to get the committee to make any move. As a result, I deliberately arranged things so that he received an appointment on the faculty of the University of California in Berkeley. Then, at the annual meeting of the Association of American Law Schools, I put on a reception to which I invited Stanley (among others) and the members of the Appointments Committee. When they came to know him, and saw some of his work, they supported my recommendation that he be invited to join the Harvard faculty. He arrived in Cambridge in 1950, and was an active member there until 1981 (except for nearly eight years when he served as Assistant Secretary of the Treasury for Tax Policy). One aspect of these machinations of mine always amuses me. After Surrey was appointed at Harvard, a faculty member at another law school came to me and said: "I was surprised that you brought Surrey to the Harvard faculty. He is your greatest competitor." I can only say that I never thought of him as a competitor. I knew him to be a remarkably able tax lawyer, with an academic bent and talent, and I knew that he would be a valued addition to the faculty .

And that he was. He soon put out his own casebook, using much more economics material than I had included in my casebook, and developing many refinements which I had thought it better to leave out of a casebook for beginners.

But that was Stanley's problem. It is the reason that I mention him here. He had a remarkable mind, which could penetrate deeply, divide thoughts into channels, and then sub-divide, and organize, and reorganize and expand in precisely thought-out details. Until Stanley became Assistant Secretary of the Treasury for Tax Policy, the tax law remained relatively simple. We have Wilbur Mills to thank for much of that. He was one who understood the importance of holding tax legislation to an understandable minimum, without expanding it into more intricate detail. But Stanley could see all the problems, and, having seen them, he felt that it was his duty to spell them out. Under his aegis, we began to have sections of the

statute with large numbers of sub-sections, and sub-sub-sections. Sometimes a single section runs in length to several pages. Many of these provisions I find baffling. One consequence has been that in many law offices there are specialties within the tax field--experts who work only on deferred compensation, or on transfer pricing, and so on.

Stanley was not only a remarkable lawyer, he was also a great teacher. In the course of time, he developed a large number of devoted followers, in the Treasury Department, and on the staff of the Joint Committee. These are the lawyers who actually write most of the statutory provisions. (I often found that very few members of Congress had any idea of what it was they had passed.) The congressional committees would adopt proposals in rather general terms, often without having any specific draft before them. Then, the able young lawyers on the staffs would go to work, thinking of all the possibilities, and drafting the statutes in great detail. In some cases, the statutory provision had been "enacted" before it was drafted. As a result, we have many highly intricate, very long, and complicated provisions in the existing tax law. The booklet of instructions published by the Internal Revenue Service for Form 1040 for 1992, including its schedules, fills about eighty-five 8.5 x 11 pages, with three columns to a page, of generally small type. In addition, these instructions include frequent references to other forms and other instructions, such as Form 1116 for the foreign tax credit, Form 6251, dealing with the alternative minimum tax, and Form 8283, dealing with noncash charitable contributions, each with its own set of instructions. I need not go into more minutiae. You are thoroughly familiar with all this. Many of those who practice in the tax field have long since been overwhelmed by all this detail.

There is another defect in our tax system which I find very troublesome. This is the upside down pyramid which we have for court review of tax cases. Nearly fifty years ago, I wrote an article on "The Need for a Court of Tax Appeals," 57 Harv. L. Rev. 1153 (1944). As we all know, most tax cases in court--about eighty percent-- are heard in what is now called the United States Tax Court. Tax cases can also be heard in the United States District Courts, where a jury trial is available, and in the United States Court for Federal Claims. After cases are heard in the trial courts, appeals then go to thirteen different courts of appeals--the eleven United States Courts of Appeals, and the Courts of Appeals for the District of Columbia Circuit and for the Federal Circuit. In the nature of things, these courts of appeals often reach conflicting results, or decisions which are hard to reconcile. The only review of their decisions is on wholly discretionary certiorari to the United States Supreme Court. As a result, there are a number of conflicting decisions. The Supreme Court hates tax cases, and there is often no practical way to resolve such conflicts. There is thus extensive delay in reaching final decisions on tax questions, and this provides opportunity for many conferences with the Service and Chief Counsel's Office in other cases involving the issue.

My proposal was to establish a single Federal Court of Tax Appeals. We came fairly close to getting that result when the Court of Appeals for the Federal Circuit was established in 1980. This would provide a relatively quick way of reaching final decisions on questions of construing and applying the tax law. It would not interfere with jury trials, which could still be had in the district courts. Nevertheless, to my regret, the practicing bar, including the Tax Section of the ABA, has always opposed this arrangement. I remember back to the early days when Robert N. Miller was the founding mover of the Tax Section, and he quite definitely did not want to have any "specialized" judges hearing tax cases. I can understand this to some extent. However, I have never been able to get over the feeling that the real reason is that tax lawyers find it advantageous to have uncertainty and delay. As long as there is a conflict of decisions, tax cases can be settled for an appreciable savings, even when it is tolerably clear that the eventual decision would be in favor of the government. It is equally true that the same thing operates in reverse. Even though the taxpayer's position is very strong, the government representative may hold out for the purpose of inducing a settlement for more than the case is really worth. Settling such a case at a discount may be cheaper than going ahead and paying the costs of trial and further appeal. It's like settling tort cases.

It is not too late for the Tax Section to recognize its responsibility in this area, and to help to promote a system that will bring about speedier final resolution of tax issues. This, in my view, is really required by our obligation to help to provide a system of tax review which actually works effectively. This is in no sense inconsistent with our duties to our clients. In this connection, I may call to mind the example of Randolph E. Paul, one of the early giants in the tax field, who had a remarkable capacity to represent clients effectively while, at the same time, maintaining his independence of view regarding the terms of the tax statute and the system for resolving tax controversies.

In recent years, there have been new developments in the organization of the profession. Law firms have grown greatly in size, and so have accounting firms. There is, I think, some risk that the old controversies between lawyers and accountants may be arising again. There are accounting firms which have a hundred tax lawyers on their staff in a single city, and the number of lawyers working directly for accounting firms today must be ten to twenty times what it was when the earlier controversies, based on "unlawful practice of law," were current. These lawyers are not representing their own clients. They are representing clients of the accounting firm. In so far as the questions are truly ones of accounting, there is no problem. But, very often, the essential question is one of the construction of the tax statute, or of the evaluation of the legality of certain courses of conduct. This gets into a troublesome zone. Most law firms have good relations with the local accounting firms, and many of these problems can be worked out with thought and care on both sides. I get the sense, though, that these problems are increasing, not only in number, but also in the legal complexity of the issues involved. This may be a problem to which attention should be directed.

On the other hand, there is a countervailing problem. In recent years, there has been some movement towards establishing what might be called the "full service law firm." What this usually involves is the creation by a law firm of one or more subsidiaries. Thus, there is an accounting subsidiary, a real estate subsidiary, a financing subsidiary, a public relations subsidiary, a lobbying subsidiary, and so on. The American Bar Association has found it difficult to come to a resolution of this issue. These subsidiaries are, in practical effect, funnels for attracting law business to the law firms. That, plus increasing revenue for the controlling firm's partners, is indeed their primary purpose. It may well be that we will soon find ourselves in a situation where the accounting firms, not to mention real estate firms, banks, and others, will have legitimate complaints that the law firms are covering the marketplace and siphoning off work which is appropriately the field of other professionals or businesses.

The real problem, I think, is the nature of what a law firm should be. Is it a business, where conglomerates are not uncommon, or is it truly a profession--in Pound's words, "the public profession of the law"? For five or six centuries, up to now, it has been proudly a profession, accepting many sorts of responsibilities, as well as providing strictly legal services, in and out of court. The fact that the practice of law is a profession, not a business, is an attraction which leads many young people to the study of law, and which gives them a strong sense of pride in their law practice, a feeling that what they are doing is a true public service, even though it is a way of making a living. Using the profession to support oneself and one's family is surely laudable. Using it to make "big money" raises fundamental questions. The wrong decision on this matter may have severe impact on the profession as it has long existed, and as it stood when we accepted membership in it. It is my fervent hope that these problems will be squarely faced by tax lawyers and other lawyers of today, and that we will continue to think of law practice as a field of public service with all the opportunities and satisfactions which are inherent in the practice of law.

I have one further point, which is a major one. It can be put concisely: the present tax law has spun out complications to the extent that it is truly monstrous. In my view, something must be done about it. I have already referred to the complexity of the statute, to the numerous forms which the IRS necessarily requires, and the pages and pages of instructions which represent a valiant effort to clarify the situation. But we have already gone too far.

Just to use myself as an example, my wife is disabled, and, as we advance in years, we need an increasing amount of household help for her assistance. One result of this is that I have to keep the appropriate records week by week and file quarterly social security tax reports. The final report must be sent to two different offices, the tax report to Philadelphia, and the report on names and social security numbers to the Social Security Administration in Santa Fe, New Mexico. Then, I must prepare several copies of a Form W-2 for each employee. The form contains twenty-nine boxes and some of the instructions which accompany it are incomprehensible to me. I must get a covering W-3 form. In addition, I have one person who assists me with professional work. This requires the preparation of several copies of a Form 1099, which must be sent to the IRS with a covering Form 1096. Then, I have to prepare quarterly unemployment tax reports to the District of Columbia, and also similar reports to Massachusetts, since one of the employees works there. And finally, I have to prepare and file a federal unemployment tax return with payment. All in all, I figure that these reports involve some forty to fifty pieces of paper, filed in five separate offices.

After this is done, I have to prepare my Form 1040 and also a form for the District of Columbia income tax. (Previously, I have also had to file income tax returns in California, Massachusetts, New York, and France, but my retirement has eliminated the need for returns in California, New York and France. And I recently changed my domicile from Massachusetts to the District of Columbia, so I no longer need to file a Massachusetts income tax return, with some complicated provisions, including the credit for taxes paid elsewhere.)

So now, I have the January papers done, consuming many hours of time, but the Form 1040 and the D.C. form lie ahead. I know from past experience that the Form 1040 will fill twenty or more pages, with further schedules, and will weigh about a quarter of a pound when I come to mail it. My problem is partly due to the fact that I have always made out my own tax returns. I started this years ago, when I figured that, as a tax professor, I ought to be able to make out my tax return. Even if I had an accountant do it, I find it hard to see that it would save much time, because it would take a great deal of time to compile the basic figures, and to explain to the accounting professional the relevant details of my situation. A further fact is that I have always included a complete list of charitable contributions as a supplement to Schedule A, and an item-by-item list of dividends received in a supplement to Schedule B. My chief motivation for this is to be sure that I get the figures right, with the further thought that when my return is compared with the reports which the IRS receives, the impression may be created that the return was carefully and accurately prepared, and I would have fewer problems with the tax officials. As a practical matter, this has worked out over the years.

Although I have not kept precise time figures, my best estimate is that the preparation of my Form 1040, and my D.C. income tax return, occupies a hundred hours. I used to type it, but now I fill it out in long-hand, and make Xerox copies for my own files.

Now I am just a simple retired law professor. There must be thousands of others who encounter similar problems of preparation. Even where the taxpayer is sensible enough to have his returns prepared by an accountant, the expense must be considerable, including the expense of advising the accountant, and consultations with him.

Similarly, the expense to business corporations in handling their taxes must be enormous. They have to prepare five copies of a 1099 for each stockholder, and cover the cost of mailing. Even with sophisticated business machines (which are expensive), it is a considerable task to compile this information. Then, on their returns, there is great expense in accumulating the data, even with modern computers, and in handling all of the accounting and legal problems which arise in preparing the return, and after it has been filed.

I need not go into this further. You are all familiar with it. The net result, in my view, is that our present tax system, which worked very well during the first third of this century, and struggled along during the second third of the century, has now come to the place where it is simply monstrous. We would never accept it if it had not just crept up on us, if the tax lawyers had not done their ingeniously intricate job. Something has to be done about it. It will be very hard to do. I do not have any very good suggestions.

There is much talk about a value-added tax--or, what amounts to about the same thing, a consumption tax. The difficulty with this is that it is highly regressive, and we need a system which is much less regressive than our present system is. Those who have worked on this problem say that a value-added tax can be devised which is not regressive. It is my fear, though, that once we start down the road of devising means which will modify the tax for persons of small incomes, we will be beginning the process which has led us to the present crisis under the income tax, which has grown out of the simple scheme which started in 1913. All that I can say now is that I think that this is a major problem. I hope that competent tax lawyers, such as the members of this College, will play a useful and important role in helping to solve it.

With that, I have hit some high points. It will be hard to bring about changes, but it is my earnest hope that tax lawyers will join in leading the way. ·

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