

The Federal Income Tax

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BEYOND A DOUBT, many prosperous and ostensibly intelligent Americans have in recent years done things that to a naïve observer might appear outlandish, if not actually lunatic. Men of inherited wealth, some of them given to the denunciation of government in all its forms and manifestations, have shown themselves to be passionately interested in the financing of state and municipal governments, and have contributed huge sums to this end. Weddings between persons with very high incomes and persons with not so high incomes have tended to take place most often near the end of December and least often during January. Some exceptionally successful people, especially in the arts, have been abruptly and urgently instructed by their financial advisers to do no more gainful work under any circumstances for the rest of the current calendar year, and have followed this advice, even though it sometimes came as early as May or June. Actors and other people with high incomes from personal services have again and again become the proprietors of sand-and-gravel businesses, bowling alleys, and telephone-answering services, doubtless adding a certain *élan* to the conduct of those humdrum establishments. Motion-picture people, as if fulfilling a clockwork schedule of renunciation and reconciliation, have repeatedly abjured their native soil in favor of foreign countries for periods of eighteen months—only to embrace it again in the nineteenth. Petroleum investors have peppered the earth of Texas with speculative oil wells, taking risks far beyond what would be dictated by normal business judgment. Businessmen travelling on planes, riding in taxis, or dining in restaurants have again and again been seen compulsively making entries in little notebooks that, if they were questioned, they would describe as “diaries;” however, far from being spiritual descendants of Samuel Pepys or Philip Hone, they were writing down only what everything cost. And owners and part owners of businesses have arranged to share their ownership with minor children, no matter how young; indeed, in at least one case of partnership agreement has been delayed pending the birth of one partner.

As hardly anyone needs to be told, all these odd actions are directly traceable to various provisions of the federal income-tax law. Since they deal with birth, marriage, work, and styles and places of living, they give some idea of the scope of the law’s social effects, but since they are confined to the affairs of the well-to-do, they give no idea of the breadth of its economic impact. Inasmuch as almost sixty-three million individual returns were filed in a typical recent year—1964—it is not surprising that the income-tax law is often spoken of as the law of the land that most directly affects the most individuals, and inasmuch as income-tax collections account for almost three-quarters

of our government's gross receipts, it is understandable that it is considered our most important single fiscal measure. (Out of a gross from all sources of a hundred and twelve billion dollars for the fiscal year that ended June 30th, 1964, roughly fifty-four and a half billion came from individual income taxes and twenty-three and a third billion from corporation income taxes.) "In the popular mind, it is THE TAX," the economics professors William J. Shultz and C. Lowell Harriss declare in their book "American Public Finance," and the writer David T. Bazelon has suggested that the economic effect of the tax has been so sweeping as to create two quite separate kinds of United States currency—before-tax money and after-tax money. At any rate, no corporation is ever formed, nor are any corporation's affairs conducted for as much as a single day, without the lavishing of earnest consideration upon the income tax, and hardly anyone in any income group can get by without thinking of it occasionally, while some people, of course, have had their fortunes or their reputations, or both, ruined as a result of their failure to comply with it. As far afield as Venice, an American visitor a few years ago was jolted to find on a brass plaque affixed to a coin box for contributions to the maintenance fund of the Basilica of San Marco the words "Deductible for U.S. Income-Tax Purposes."

A good deal of the attention given to the income tax is based on the proposition that the tax is neither logical nor equitable. Probably the broadest and most serious charge is that the law has close to its heart something very much like a lie; that is, it provides for taxing incomes at steeply progressive rates, and then goes on to supply an array of escape hatches so convenient that hardly anyone, no matter how rich, need pay the top rates or anything like them. For 1960, taxpayers with reportable incomes of between two hundred thousand and five hundred thousand dollars paid, on the average, about 44 per cent, and even those few who reported incomes of over a million dollars paid well under 50 per cent—which happened to be just about the percentage that a single taxpayer was supposed to pay, and often did pay, if his income was forty-two thousand dollars. Another frequently heard charge is that the income tax is a serpent in the American Garden of Eden, offering such tempting opportunities for petty evasion that it induces a national fall from grace every April. Still another school of critics contends that because of its labyrinthine quality (the basic statute, the Internal Revenue Code of 1954, runs to more than a thousand pages, and the court rulings and Internal Revenue Service regulations that elaborate it come to seventeen thousand) the income tax not only results in such idiocies as gravel-producing actors and unborn partners but is in fact that anomaly, a law that a citizen may be unable to comply with by himself. This situation, the critics declare, leads to an undemocratic state of affairs, for only the rich can afford the expensive professional advice necessary to minimize their taxes legally.

The income-tax law *in toto* has virtually no defenders, even though most fair-minded students of the subject agree that its effect over the half century that it has been in force has been to bring about a huge and healthy redistribution of wealth. When it comes to the income tax, we almost all want reform. As reformers, however, we are largely powerless, the chief reasons being the staggering complexity of the whole subject, which causes many people's minds to go blank at the very mention of it, and the specific, knowledgeable, and energetic advocacy by small groups of the particular provisions they benefit from. Like any tax law, ours had a kind of immunity to reform; the very riches that people accumulate through the use of tax-avoidance devices can be—and constantly are—applied to fighting the elimination of those devices. Such influences, combined with the fierce demands made on the Treasury by defense spending and other rising costs of government (even leaving aside hot wars like the one in Vietnam), have brought about two tendencies so marked that they have assumed the shape of a natural political law: In the United States it is comparatively easy to raise tax rates and

to introduce tax-avoidance devices, and it is comparatively hard to lower tax rates and to eliminate tax-avoidance devices. Or so it seemed until 1964, when half of this natural law was spectacularly challenged by legislation, originally proposed by President Kennedy and pushed forward by President Johnson, that reduced the basic rates on individuals in two stages from a bottom of 20 per cent to a bottom of 14 per cent and from a top of 91 per cent to a top of 70 per cent, and reduced the top tax on corporations from 52 per cent to 48 per cent—all in all, by far the largest tax cut in our history. Meanwhile, however, the other half of the natural law remains immaculate. To be sure, the proposed tax changes advanced by President Kennedy included a program of substantial reforms to eliminate tax-avoidance devices, but so great was the outcry against the reforms that Kennedy himself soon abandoned most of them, and virtually none of them were enacted; on the contrary, the new law actually extended or enlarged one or two of the devices.

“Let’s face it, Clitus, we live in a tax era. Everything’s taxes,” one lawyer says to another in Louis Auchincloss’s book of short stories called “Powers of Attorney,” and the second lawyer, a traditionalist, can enter only a token demurrer. Considering the omnipresence of the income tax in American life, however, it is odd how rarely one encounters references to it in American fiction. This omission probably reflects the subject’s lack of literary elegance, but it may also reflect a national uneasiness about the income tax—a sense that we have willed into existence, and cannot will out of existence, a presence not wholly good or wholly bad but, rather, so immense, outrageous, and morally ambiguous that it cannot be encompassed by the imagination. How in the world, one may ask, did it all happen?

AN income tax can be truly effective only in an industrial country where there are many wage and salary earners, and the annals of income taxation up to the present century are comparatively short and simple. The universal taxes of ancient times, like the one that brought Mary and Joseph to Bethlehem just before the birth of Jesus, were invariably head taxes, with one fixed sum to be paid by everybody, rather than income taxes. Before about 1800, only two important attempts were made to establish income taxes—one in Florence during the fifteenth century, and the other in France during the eighteenth. Generally speaking, both represented efforts by grasping rulers to mulct their subjects. According to the foremost historian of the income tax, the late Edwin R. A. Seligman, the Florentine effort withered away as a result of corrupt and inefficient administration. The eighteenth-century French tax, in the words of the same authority, “soon became honeycombed with abuses” and degenerated into “a completely unequal and thoroughly arbitrary imposition upon the less well-to-do classes,” and, as such, it undoubtedly played its part in whipping up the murderous fervor that went into the French Revolution. The rate of the *ancien-régime* tax, which was enacted by Louis XIV in 1710, was 10 per cent, a figure that was cut in half later, but not in time; the revolutionary regime eliminated the tax along with its perpetrators. In the face of this cautionary example, Britain enacted an income tax in 1798 to help finance her participation in the French revolutionary wars, and this was, in several respects, the first modern income tax; for one thing, it had graduated rates, progressing from zero, on annual incomes under sixty pounds, to 10 per cent, on incomes of two hundred pounds or more, and, for another, it was complicated, containing a hundred and twenty-four sections, which took up a hundred and fifty-two pages. Its unpopularity was general and instantaneous, and a spate of pamphlets denouncing it soon appeared; one pamphleteer, who purported to be looking back at ancient barbarities from the year 2000, spoke of the income-tax collectors of old as “merciless mercenaries” and “brutes ... with all the rudeness that insolence and self-important ignorance could suggest.” After yielding only about six million pounds a year for three

years—in large part because of widespread evasion—it was repealed in 1802, after the Treaty of Amiens, but the following year, when the British treasury again found itself in straitened circumstances, Parliament enacted a new income-tax law. This one was extraordinarily far ahead of its time, in that it included a provision for the withholding of income at the source, and, perhaps for that reason, it was hated even more than the earlier tax had been, even though its top rate was only half as high. At a protest meeting held in the City of London in July, 1803, several speakers made what, for Britons, must surely have been the ultimate commitment of enmity toward the income tax. If such a measure were necessary to save the country, they said, then they would reluctantly have to choose to let the country go.

Yet gradually, despite repeated setbacks, and even extended periods of total oblivion, the British income tax began to flourish. This may have been, as much as anything else, a matter of simple habituation, for a common thread runs through the history of income taxes everywhere: Opposition is always at its most reckless and strident at the very outset; with every year that passes, the tax tends to become stronger and the voices of its enemies more muted. Britain's income tax was repealed the year after the victory at Waterloo, was revived in a halfhearted way in 1832, was sponsored with enthusiasm by Sir Robert Peel a decade later, and remained in effect thereafter. The basic rate during the second half of the nineteenth century varied between 5 per cent and less than 1 per cent, and it was only 2½ per cent, with a modest surtax on high incomes, as late as 1913. The American idea of very high rates on high incomes eventually caught on in Britain, though, and by the middle 1960's the top British bracket was over 90 per cent.

Elsewhere in the world—or at least in the economically developed world—country after country took the cue from Britain and instituted an income tax at one time or another during the nineteenth century. Post-revolutionary France soon enacted an income tax, but then repealed it and managed to get along without one for a number of years in the second half of the century; eventually, though, the loss of revenue proved to be intolerable, and the tax returned, to become a fixture of the French economy. An income tax was one of the first, if not one of the sweetest, fruits of Italian unity, while several of the separate states that were to combine into the German nation had income taxes even before they were united. By 1911, income taxes also existed in Austria, Spain, Belgium, Sweden, Norway, Denmark, Switzerland, Holland, Greece, Luxembourg, Finland, Australia, New Zealand, Japan, and India.

As for the United States, the enormous size of whose income-tax collections and the apparent docility of whose taxpayers are now the envy of governments everywhere, it was a laggard in the matter of instituting an income tax and for years was an inveterate backslider in the matter of keeping one on its statute books. It is true that in Colonial times there were various revenue systems bearing some slight resemblance to income taxes—in Rhode Island at one point, for example, each citizen was supposed to guess the financial status of ten of his neighbors, in regard to both income and property, in order to provide a basis for tax assessments—but such schemes, being inefficient and subject to obvious opportunities for abuse, were short-lived. The first man to propose a federal income tax was President Madison's Secretary of the Treasury, Alexander J. Dallas; he did so in 1814, but a few months later the War of 1812 ended, the demand for government revenue eased, and the Secretary was hooted down so decisively that the subject was not revived until the time of the Civil War, when both the Union and the Confederacy enacted income-tax bills. Before 1900, very few new income taxes appear to have been enacted anywhere without the stimulus of a war. National income taxes were—and until quite recently largely remained—war and defense measures. In June of 1862, prodded by public concern over a public debt that was increasing at the rate of two million

dollars a day, Congress reluctantly passed a law providing for an income tax at progressive rates up to a maximum of 10 per cent, and on July 1st President Lincoln signed it into law, along with a bill to punish the practice of polygamy. (The next day, stocks on the New York Exchange took a dive, which was probably not attributable to the polygamy bill.)

“I am taxed on my income! This is perfectly gorgeous! I never felt so important in my life before,” Mark Twain wrote in the Virginia City, Nevada, *Territorial Enterprise* after he had paid his first income-tax bill, for the year 1864—\$36.82, including a penalty of \$3.12 for being late. Although few other taxpayers were so enthusiastic, the law remained in force until 1872. It was, however, subjected to a succession of rate reductions and amendments, one of them being the elimination, in 1865, of its progressive rates, on the arresting ground that collecting 10 per cent on high incomes and lower rates on lower incomes constituted undue discrimination against wealth. Annual revenue collections mounted from two million dollars in 1863 to seventy-three million in 1866, and then descended sharply. For two decades, beginning in the early eighteen-seventies, the very thought of an income tax did not enter the American mind, apart from rare occasions when some Populist or Socialist agitator would propose the establishment of such a tax designed specifically to soak the urban rich. Then, in 1893, when it had become clear that the country was relying on an obsolete revenue system that put too little burden on businessmen and members of the professions, President Cleveland proposed an income tax. The outcry that followed was shrill. Senator John Sherman, of Ohio, the father of the Sherman Antitrust Act, called the proposal “socialism, communism, and devilism,” and another senator spoke darkly of “the professors with their books, the socialists with their schemes ... [and] the anarchists with their bombs,” while over in the House a congressman from Pennsylvania laid his cards on the table in the following terms:

An income tax! A tax so odious that no administration ever dared to impose it except in time of war.... It is unutterably distasteful both in its moral and material aspects. It does not belong to a free country. It is class legislation.... Do you desire to offer a reward to dishonesty and to encourage perjury? The imposition of the tax will corrupt the people. It will bring in its train the spy and the informer. It will necessitate a swarm of officials with inquisitorial powers.... Mr. Chairman, pass this bill and the Democratic Party signs its death warrant.

The proposal that gave rise to these fulminations was for a tax at a uniform rate of 2 per cent on income in excess of four thousand dollars, and it was enacted into law in 1894. The Democratic Party survived, but the new law did not. Before it could be put into force, it was thrown out by the Supreme Court, on the ground that it violated the Constitutional provision forbidding “direct” taxes unless they were apportioned among the states according to population (curiously, this point had not been raised in connection with the Civil War income tax), and the income-tax issue was dead again, this time for a decade and a half. In 1909, by what a tax authority named Jerome Hellerstein has called “one of the most ironic twists of political events in American history,” the Constitutional amendment (the sixteenth) that eventually gave Congress the power to levy taxes without apportionment among the states was put forward by the implacable opponents of the income tax, the Republicans, who took the step as a political move, confidently believing that the amendment would never be ratified by the states. To their dismay, it was ratified in 1913, and later that year Congress enacted a graduated tax on individuals at rates ranging from 1 per cent to 7 per cent, and also a flat tax of 1 per cent on the net profits of corporations. The income tax has been with us ever since.

By and large, its history since 1913 has been one of rising rates and of the seasonable appearance of special provisions to save people in the upper brackets from the inconvenience of having to pay those rates. The first sharp rise took place during the First World War, and by 1918 the bottom rate

was 6 per cent and the top one, applicable to taxable income in excess of a million dollars, was 77 per cent, or far more than any government had previously ventured to exact on income of any amount. But the end of the war and the “return to normalcy” brought a reversal of the trend, and there followed an era of low taxes for rich and poor alike. Rates were reduced by degrees until 1925, when the standard rate scale ran from 1½ per cent to an absolute top of 25 per cent, and, furthermore, a great majority of the country’s wage earners were relieved of paying any tax at all by being allowed personal exemptions of fifteen hundred dollars for a single person, thirty-five hundred dollars for a married couple, and four hundred dollars for each dependent. This was not the whole story, for it was during the twenties that special-interest provisions began to appear, stimulated into being by the complex of political forces that has accounted for their increase at intervals ever since. The first important one, adopted in 1922, established the principle of favored treatment for capital gains; this meant that money acquired through a rise in the value of investments was, for the first time, taxed at a lower rate than money earned in wages or for services—as, of course, it still is today. Then, in 1926, came the loophole that has undoubtedly caused more gnashing of teeth among those not in a position to profit by it than any other—the percentage depletion allowance on petroleum, which permits the owner of a producing oil well to deduct from his taxable income up to 27½ per cent of his gross annual income from the well and to keep deducting that much year after year, even though he has deducted the original cost of the well many times over. Whether or not the twenties were a golden age for the American people in general, they were assuredly a golden age for the American taxpayer.

The depression and the New Deal brought with them a trend toward higher tax rates and lower exemptions, which led up to a truly revolutionary era in federal income taxation—that of the Second World War. By 1936, largely because of greatly increased public spending, rates in the higher brackets were roughly double what they had been in the late twenties, and the very top bracket was 79 per cent, while, at the low end of the scale, personal exemptions had been reduced to the point where a single person was required to pay a small tax even if his income was only twelve hundred dollars. (As a matter of fact, at that time most industrial workers’ incomes did not exceed twelve hundred dollars.) In 1944 and 1945, the rate scale for individuals reached its historic peak—23 per cent at the low end and 94 per cent at the high one—while income taxes on corporations, which had been creeping up gradually from the original 1913 rate of 1 per cent, reached the point where some companies were liable for 80 per cent. But the revolutionary thing about wartime taxation was not the very high rates on high incomes; indeed, in 1942, when this upward surge was approaching full flood, a new means of escape for high-bracket taxpayers appeared, or an old one widened, for the period during which stocks or other assets must be held in order to benefit from the capital-gains provision was reduced from eighteen months to six. What was revolutionary was the rise of industrial wages and the extension of substantial tax rates to the wage earner, making him, for the first time, an important contributor to government revenue. Abruptly, the income tax became a mass tax.

And so it has remained. Although taxes on big and middle-sized businesses settled down to a flat rate of 52 per cent, rates on individual income did not change significantly between 1945 and 1964. (That is to say, the basic rates did not change significantly; there were temporary remissions, amounting to anywhere from 5 per cent to 17 per cent of the sums due under the basic rates, during the years 1946 through 1950.) The range was from 20 per cent to 91 per cent until 1950; there was a small rise during the Korean War, but it went right back there in 1954. In 1950, another important escape route, the so-called “restricted stock option,” opened up, enabling some corporate executives to be taxed on part of their compensation at low capital-gains rates. The significant change, invisible in the rate schedule, has been a continuation of the one begun in wartime; namely, the increase in the

proportionate tax burden carried by the middle and lower income groups. Paradoxical as it may seem, the evolution of our income tax has been from a low-rate tax relying for revenue on the high income group to a high-rate tax relying on the middle and lower-middle income groups. The Civil War levy, which affected only one per cent of the population, was unmistakably a rich man's tax, and the same was true of the 1913 levy. Even in 1918, at the height of the budget squeeze produced by the First World War, less than four and a half million Americans, of a total population of more than a hundred million, had to file income-tax returns at all. In 1933, in the depths of the depression, only three and three-quarters million returns were filed, and in 1939 an élite consisting of seven hundred thousand taxpayers, of a population of a hundred and thirty million, accounted for nine-tenths of all income-tax collections, while in 1960 it took some thirty-two million taxpayers—something over one-sixth of the population—to account for nine-tenths of all collections, and a whopping big nine-tenths it was, totalling some thirty-five and a half billion dollars, compared to less than a billion in 1939.

The historian Seligman wrote in 1911 that the history of income taxation the world over consisted essentially of "evolution toward basing it on ability to pay." One wonders what qualifications he might add, on the basis of the American experience since then, if he were still alive. Of course, one reason people with middle incomes pay far more in taxes than they used to is that there are far more of them. Changes in the country's social and economic structure have been as big a factor in the shift as the structure of the income tax has. It remains probable, though, that, in actual practice, the aboriginal income tax of 1913 extracted money from citizens with stricter regard to their ability to pay than the present income tax does.

WHATEVER the faults of our income-tax law, it is beyond question the best-obeyed income-tax law in the world, and income taxes are now ubiquitous, from the Orient to the Occident and from pole to pole. (Practically all of the dozens of new nations that have come into being over the past few years have adopted income-tax measures. Walter H. Diamond, the editor of a publication called *Foreign Tax & Trade Briefs*, has noted that as recently as 1955 he could rattle off the names of two dozen countries, large and small, that did not tax the individual, but that in 1965 the only names he could rattle off were those of a couple of British colonies, Bermuda and the Bahamas; a couple of tiny republics, San Marino and Andorra; three oil-rich Middle Eastern countries, the Sultanate of Muscat and Oman, Kuwait, and Qatar; and two rather inhospitable countries, Monaco and Saudi Arabia, which taxed the incomes of resident foreigners but not those of nationals. Even Communist countries have income taxes, though they count on them for only a small percentage of their total revenue; Russia applies different rates to different occupations, shopkeepers and ecclesiastics being in the high tax bracket, artists and writers near the middle, and laborers and artisans at the bottom.) Evidence of the superior efficiency of tax collecting in the United States is plentiful; for instance, our costs for administration and enforcement come to only about forty-four cents for every hundred dollars collected, as against a rate more than twice as high in Canada, more than three times as high in England, France, and Belgium, and many times as high in other places. This kind of American efficiency is the despair of foreign tax collectors. Toward the end of his term in office Mortimer M. Caplin, who was commissioner of Internal Revenue from January, 1961, until July, 1964, held consultations with the leading tax administrators of six Western European countries, and the question heard again and again was "How do you do it? Do they *like* to pay taxes over there?" Of course, they do not, but, as Caplin said at the time, "we have a lot going for us that the Europeans haven't." One thing we have going for us is tradition. American income taxes originated and developed not as a result of the efforts of monarchs to fill their coffers at the expense of their subjects but as a result of

the efforts of an elected government to serve the general interest. A widely travelled tax lawyer observed not long ago, "In most countries, it's impossible to engage in a serious discussion of income taxes, because they aren't taken seriously." They are taken seriously here, and part of the reason is the power and skill of our income-tax police force, the Internal Revenue Service.

Unquestionably, the "swarm of officials" feared by the Pennsylvania congressman in 1894 has come into being—and there are those who would add that the officials have the "inquisitorial powers" he also feared. As of the beginning of 1965, the Internal Revenue Service had approximately sixty thousand employees, including more than six thousand revenue officers and more than twelve thousand revenue agents, and these eighteen thousand men, possessing the right to inquire into every penny of everyone's income and into matters like exactly what was discussed at an expense-account meal, and armed with the threat of heavy punishments, have powers that might reasonably be called inquisitorial. But the I.R.S. engages in many activities besides actual tax collecting, and some of these suggest that it exercises its despotic powers in an equitable way, if not actually in a benevolent one. Notable among the additional activities is a taxpayer-education program on a scale that occasionally inspires an official to boast that the I.R.S. runs the largest university in the world. As part of this program, it puts out dozens of publications explicating various aspects of the law, and it is proud of the fact that the most general of these—a blue-covered pamphlet entitled "Your Federal Income Tax," which is issued annually and in 1965 could be bought for forty cents at any District Director's office—is so popular that it is often reprinted by private publishers, who sell it to the unwary for a dollar or more, pointing out, with triumphant accuracy, that it is an official government publication. (Since government publications are not copyrighted, this is perfectly legal.) The I.R.S. also conducts "institutes" on technical questions every December for the enlightenment of the vast corps of "tax practitioners"—accountants and lawyers—who will shortly be preparing the returns of individuals and corporations. It puts out elementary tax manuals designed specially for free distribution to any high schools that ask for them—and, according to one I.R.S. official, some eighty-five per cent of American high schools did ask for them in one recent year. (The question of whether schoolchildren ought to be spending their time boning up on the tax laws is one that the I.R.S. considers to be outside its scope.) Furthermore, just before the tax deadline each year, the I.R.S. customarily goes on television with spot advertisements offering tax pointers and reminders. It is proud to say that, of the various spots, a clear majority have been in the interests of protecting taxpayers from overpaying.

In the fall of 1963, the I.R.S. took a big step toward increasing the efficiency of its collections still further, and, by a feat worthy of the wolf in "Little Red Riding Hood," it managed to present the step to the public as a grandmotherly move to help everybody out. The step was the establishment of a so-called national-identity file, involving the assignment to every taxpayer of an account number (usually his Social Security number), and its intention was to practically eliminate the problem created by people who fail to declare their income from corporate dividends or from interest on bank accounts or bonds—a form of evasion that was thought to have been costing the Treasury hundreds of millions a year. But that is not all. When the number is entered in the proper place on a return, "this will make certain that you are given immediate credit for taxes reported and paid by you, and that any refund will be promptly recorded in your favor"—so Commissioner Caplin commented brightly on the front cover of the 1964 tax-return forms. The I.R.S. then began taking another giant step—the adoption of a system for automating a large part of the tax-checking process, in which seven regional computers would collect and collate data that would be fed into a master data-processing center at Martinsburg, West Virginia. This installation, designed to make a quarter of a million number comparisons per second, began to be called the Martinsburg Monster even before it was in full operation. In 1965,

between four and five million returns a year were given a complete audit, and all returns were checked for mathematical errors. Some of this mathematical work was being done by computers and some by people, but by 1967, when the computer system was going full blast, *all* the mathematical work was done by machine, thus freeing many I.R.S. employees to subject even more returns to detailed audits. According to a publication authorized by the I.R.S. back in 1963, though, “the capacity and memory of the [computer] system will help taxpayers who forget prior year credits or who do not take full advantage of their rights under the laws.” In short, it was going to be a *friendly* monster.

IF the mask that the I.R.S. had presented to the country in recent years has worn a rather ghastly expression of benignity, part of the explanation is probably nothing more sinister than the fact that Caplin, the man who dominated it in those years, is a cheerful extrovert and a natural politician, and that his influence continued to be felt under the man who was appointed to succeed him as Commissioner in December 1964—a young Washington lawyer named Sheldon S. Cohen, who took over the job after a six-month interim during which an I.R.S. career man named Bertrand M. Harding served as Acting Commissioner. (When Caplin resigned as Commissioner, he stepped out of politics, at least temporarily, returning to his Washington law practice as a specialist in, among other things, the tax problems of businessmen.) Caplin is widely considered to have been one of the best Commissioners of Internal Revenue in history, and, at the very least, he was certainly an improvement on two fairly recent occupants of the post, one of whom, some time after leaving it, was convicted and sentenced to two years in prison for evading his own income taxes, and the other of whom subsequently ran for public office on a platform of opposition to any federal income tax—as a former umpire might stump the country against baseball. Among the accomplishments that Mortimer Caplin, a small, quick-spoken, dynamic man who grew up in New York City and used to be a University of Virginia law professor, is credited with as Commissioner is the abolition of the practice that had previously been alleged to exist of assigning collection quotas to I.R.S. agents. He gave the top echelons of I.R.S. an air of integrity beyond cavil, and, what was perhaps most striking, managed the strange feat of projecting to the nation a sort of enthusiasm for taxes, considered abstractly. Thus he managed to collect them with a certain style—a sort of subsidiary New Frontier, which he called the New Direction. The chief thrust of the New Direction was to put increased emphasis on education leading toward increased voluntary compliance with the tax law, instead of concentrating on the search for and prosecution of conscious offenders. In a manifesto that Caplin issued to his swarm of officials in the spring of 1961, he wrote, “We all should understand that the Service is not simply running a direct enforcement business aimed at making \$2 billion in additional assessments, collecting another billion from delinquent accounts, and prosecuting a few hundred evaders. Rather, it is charged with administering an enormous self-assessment tax system which raises over \$90 billion from what people themselves put down on their tax returns and voluntarily pay, with another \$2 or \$3 billion coming from direct enforcement activities. In short, we cannot forget that 97 per cent of our total revenue comes from self-assessment or voluntary compliance, with only three per cent coming directly from enforcement. *Our chief mission is to encourage and achieve more effective voluntary compliance....* The New Direction is really a shift in emphasis. *But it is a very important shift.*” It may be, though, that the true spirit of the New Direction is better epitomized on the jacket of a book entitled “The American Way in Taxation,” edited by Lillian Doris, which was published in 1963 with the blessing of Caplin, who wrote the foreword. “Here is the exciting story of the largest and most efficient tax collecting organization the world has ever known—the United States Internal Revenue

Service!” the jacket announced, in part. “Here are the stirring events, the bitterly-fought legislative battles, the dedicated civil servants that have marched through the past century and left an indelible imprint on our nation. You’ll thrill to the epic legal battle to kill the income tax ... and you’ll be astonished at the future plans of the I.R.S. You’ll see how giant computers, now on the drawing boards, are going to affect the tax collection system and influence the lives of many American men and women in new and unusual ways!” It sounded a bit like a circus barker hawking a public execution.

It is debatable whether the New Direction watchword of “voluntary compliance” could properly be used to describe a system of tax collection under which some three-quarters of all collections from individuals are obtained through withholding at the source, under which the I.R.S. and its Martinsburg Monster lurk to catch the unwary evader, and under which the punishment for evasion runs up to five years in prison per offense in addition to extremely heavy financial penalties. Caplin, however, did not seem to feel a bit of concern over this point. With tireless good humor, he made the rounds of the nation’s organizations of businessmen, accountants, and lawyers, giving luncheon talks in which he praised them for their voluntary compliance in the past, exhorted them to greater efforts in the future, and assured them that it was all in a good cause. “We’re still striving for the human touch in our tax administration,” declared the essay on the cover of the 1964 tax-return forms, which Caplin signed, and which he says he composed in collaboration with his wife. “I see a lot of humor in this job,” he told a caller a few hours after remarking to a luncheon meeting of the Kiwanis Club of Washington at the Mayflower Hotel, “Last year was the fiftieth anniversary of the income-tax amendment to the Constitution, but the Internal Revenue Service somehow or other didn’t seem to get any birthday cakes.” This might perhaps be considered a form of gallows humor, except that the hangman is not supposed to be the one who makes the jokes.

Cohen, the Commissioner who succeeded Caplin and was still in office in mid-1968, is a born-and-bred Washingtonian who, in 1952, graduated from George Washington University Law School at the top of his class; served in a junior capacity with the I.R.S. for the next four years; practiced law in Washington for seven years after that, eventually becoming a partner in the celebrated firm of Arnold, Fortas & Porter; at the beginning of 1964 returned to the I.R.S., as its chief counsel; and a year later, at the age of thirty-seven, became the youngest Commissioner of Internal Revenue in history. A man with close-cropped brown hair, candid eyes, and a guileless manner that makes him seem even younger than he is, Cohen came from the chief counsel’s office with the reputation of having uplifted it both practically and philosophically; he was responsible for an administrative reorganization that has been widely praised as making faster decisions possible, and for a demand that the I.R.S. be consistent in its legal stand in cases against taxpayers (that it refrain from taking one position on a fine point of Code interpretation in Philadelphia, say, and the opposite position on the same point in Omaha), which is considered a triumph of high principle over governmental greed. In general, Cohen said upon assuming office, he intended to continue Caplin’s policies—to emphasize “voluntary compliance,” to strive for agreeable, or at least not *disagreeable*, relations with the taxpaying public, and so on. He is a less gregarious and a more reflective man than Caplin, however, and this difference has had its effect on the I.R.S. as a whole. He has stuck relatively close to his desk, leaving the luncheon-circuit pep talks to subordinates. “Mort was wonderful at that sort of thing,” Cohen said in 1965. “Public opinion of the Service is high now as a result of his big push in that direction. We want to keep it high without more pushing on my part. Anyhow, I couldn’t do it well—I’m not made that way.”

A charge that has often been made, and continues to be made, is that the office of Commissioner

carries with it far too much power. The Commissioner has no authority to propose changes in rates or initiate other new tax legislation—the authority to propose rate changes belongs to the Secretary of the Treasury, who may or may not seek the Commissioner’s advice in the matter, and the enactment of new tax laws is, of course, the job of Congress and the President—but tax laws, since they must cover so many different situations, are necessarily written in rather general terms, and the Commissioner is solely responsible (subject to reversal in the courts) for writing the regulations that are supposed to explain the laws in detail. And sometimes the regulations are a bit cloudy themselves, and in such cases who is better qualified to explain *them* than their author, the Commissioner? Thus it comes about that almost every word that drops from the Commissioner’s mouth, whether at his desk or at luncheon meetings, is immediately distributed by the various tax publishing services to tax accountants and lawyers all over the country and is gobbled up by them with an avidity not always accorded the remarks of an appointed official. Because of this, some people see the Commissioner as a virtual tyrant. Others, including both theoretical and practical tax experts, disagree. Jerome Hellerstein, who is a law professor at New York University Law School as well as a tax adviser, says, “The latitude of action given the Commissioner is great, and it’s true that he can do things that may affect the economic development of the country as well as the fortunes of individuals and corporations. But if he had small freedom of action, it would result in rigidity and certainty of interpretation, and would make it much easier for tax practitioners like me to manipulate the law to their clients’ advantage. The Commissioner’s latitude gives him a healthy unpredictability.”

CERTAINLY Caplin did not knowingly abuse his power, nor has Cohen done so. Upon visiting first one man and then the other in the Commissioner’s office, I found that both conveyed the impression of being men of high intelligence who were living—as Arthur M. Schlesinger, Jr., has said that Thoreau lived—at a high degree of moral tension. And the cause of the moral tension is not hard to find; it almost surely stemmed from the difficulty of presiding over compliance, voluntary or involuntary, with a law of which one does not very heartily approve. In 1958, when Caplin appeared—as a witness versed in tax matters, rather than as Commissioner of Internal Revenue—before the House Ways and Means Committee, he proposed an across-the-board program of reforms, including, among other things, either the total elimination or a drastic curbing of favored treatment for capital gains; the lowering of percentage depletion rates on petroleum and other minerals; the withholding of taxes on dividends and interest; and the eventual drafting of an entirely new income-tax law to replace the 1954 Code, which he declared had led to “hardships, complexities, and opportunities for tax avoidance.” Shortly after Caplin left office, he explained in detail what his ideal tax law would be like. Compared to the present tax law, it would be heroically simple, with loopholes eliminated, and most personal deductions and exemptions eliminated, too, and with a rate scale ranging from 10 to 50 per cent.

In Caplin’s case, the resolution of moral tension, insofar as he achieved it, was not entirely the result of rational analysis. “Some critics take a completely cynical view of the income tax,” he mused one day during his stint as Commissioner. “They say, in effect, ‘It’s a mess, and nothing can be done about it.’ I can’t go along with that. True, many compromises are necessary, and will continue to be. But I refuse to accept a defeatist attitude. There’s a mystic quality about our tax system. No matter how bad it may be from the technical standpoint, it has a vitality because of the very high level of compliance.” He paused for quite a long time, perhaps finding a flaw in his own argument; in the past, after all, universal compliance with a law has not always been a sign that it was either intelligent or just. Then he went on, “Looking over the sweep of years, I think we’ll come out well. Probably a

point of crisis of some kind will make us begin to see beyond selfish interests. I'm optimistic that fifty years from now we'll have a pretty good tax."

As for Cohen, he was working in the legislation-drafting section of the I.R.S. at the time the present Code was written, and he had a hand in its composition. One might suppose that this fact would cause him to have a certain proprietary feeling toward it, but apparently that is not so. "Remember that we had a Republican administration then, and I'm a Democrat," he said one day in 1965. "When you are drafting a statute, you operate as a technician. Any pride you may feel afterward is pride in technical competence." So Cohen can reread his old prose, now enshrined as law, with neither elation nor remorse, and he has not the slightest hesitation about endorsing Caplin's opinion that the Code leads to "hardships, complexities, and opportunities for tax avoidance." He is more pessimistic than Caplin about finding the answer in simplification. "Perhaps we can move the rates down and get rid of some deductions," he says, "but then we may find we need new deductions, in the interests of fairness. I suspect that a complex society requires a complex tax law. If we put in a simpler code, it would probably be complex again in a few years."

II

"EVERY nation has the government it deserves," the French writer and diplomat Joseph de Maistre declared in 1811. Since the primary function of government is to make laws, the statement implies that every nation has the laws it deserves, and if the doctrine may be considered at best a half truth in the case of governments that exist by force, it does seem persuasive in the case of governments that exist by popular consent. If the single most important law now on the statute books of the United States is the income-tax law, it would follow that we must have the income-tax law we deserve. Much of the voluminous discussion of the income-tax law in recent years has centered on plain violations of it, among them the deliberate padding of tax-deductible business-expense accounts, the matter of taxable income that is left undeclared on tax returns, fraudulently or otherwise—a sum estimated at as high as twenty-five billion dollars a year—and the matter of corruption within the ranks of the Internal Revenue Service, which some authorities believe to be fairly common, at least in large cities. Such forms of outlawry, of course, reflect timeless and worldwide human frailties. The law itself, however, has certain characteristics that are more closely related to a particular time and place, and if de Maistre was right, these should reflect national characteristics; the income-tax law, that is, should be to some extent a national mirror. How does the reflection look?

TO repeat, then, the basic law under which income taxes are now imposed is the Internal Revenue Code of 1954, as amplified by innumerable regulations issued by the Internal Revenue Service, interpreted by innumerable judicial decisions, and amended by several Acts of Congress, including the Revenue Act of 1964, which embodied the biggest tax cut in our history. The Code, a document longer than "War and Peace," is phrased—inevitably, perhaps—in the sort of jargon that stuns the mind and disheartens the spirit; a fairly typical sentence, dealing with the definition of the word "employment," starts near the bottom of page 564, includes more than a thousand words, nineteen semicolons, forty-two simple parentheses, three parentheses within parentheses, and even one unaccountable interstitial period, and comes to a gasping end, with a definitive period, near the top of page 567. Not until one has penetrated to the part of the Code dealing with export-import taxes

(which fall within its province, along with estate taxes and various other federal imposts) does one come upon a comprehensible and diverting sentence like “Every person who shall export oleomargarine shall brand upon every tub, firkin, or other package containing such article the word ‘Oleomargarine,’ in plain Roman letters not less than one-half inch square.” Yet a clause on page 2 of the Code, though it is not a sentence at all, is as clear and forthright as one could wish; it sets forth without ado the rates at which the incomes of single individuals are to be taxed: 20 per cent on taxable income of not over \$2,000; 22 per cent on taxable income of over \$2,000 but not over \$4,000; and so on up to a top rate of 91 per cent on taxable income of over \$200,000. (As we have seen, the rates were amended downward in 1964 to a top of 70 per cent.) Right at the start, then, the Code makes its declaration of principle, and, to judge by the rate table, it is implacably egalitarian, taxing the poor relatively lightly, the well-to-do moderately, and the very rich at levels that verge on the confiscatory.

But, to repeat a point that has become so well known that it scarcely needs repeating, the Code does not live up to its principles very well. For proof of this, one need look no further than some of the recent score sheets of the income tax—a set of volumes entitled *Statistics of Income*, which are published annually by the Internal Revenue Service. For 1960, individuals with gross incomes of between \$4,000 and \$5,000, after taking advantage of all their deductions and personal exemptions, and availing themselves of the provision that allows married couples and the heads of households to be taxed at rates generally lower than those for single persons, ended up paying an average tax bill of about one-tenth of their reportable receipts, while those in the \$10,000–\$15,000 range paid a bill of about one-seventh, those in the \$25,000–\$50,000 range paid a bill of not quite a quarter, and those in the \$50,000–\$100,000 range paid a bill of about a third. Up to this point, clearly, we find a progression according to ability to pay, much as the rate table prescribes. However, the progression stops abruptly when we reach the top income brackets—that is, at just the point where it is supposed to become most marked. For 1960, the \$150,000–\$200,000, \$200,000–\$500,000, \$500,000–\$1,000,000 and million-plus groups each paid, on the average, less than 50 per cent of their reportable incomes, and when one takes into consideration the fact that the richer a man is, the likelier it is that a huge proportion of his money need not even be reported as gross taxable income—all income from certain bonds, for example, and half of all income from long-term capital gains—it becomes evident that at the very top of the income scale the percentage rate of actual taxation turns downward. The evidence is confirmed by the *Statistics of Income* for 1961, which breaks down figures on payments according to bracket, and which shows that although 7,487 taxpayers declared gross incomes of \$200,000 or more, fewer than five hundred of them had net income that was taxed at the rate of 91 per cent. Throughout its life, the rate of 91 per cent was a public tranquilizer, making everyone in the lower bracket feel fortunate not to be rich, and not hurting the rich very much. And then, to top off the joke, if that is what it is, there are the people with more income than anyone else who pay less tax than anyone else—that is, those with annual incomes of a million dollars or more who manage to find perfectly legal ways of paying no income tax at all. According to *Statistics of Income*, there were eleven of them in 1960, out of a national total of three hundred and six million-a-year men, and seventeen in 1961, out of a total of three hundred and ninety-eight. In plain fact, the income tax is hardly progressive at all.

The explanation of this disparity between appearance and reality, so huge that it lays the Code open to a broad accusation of hypocrisy, is to be found in the detailed exceptions to the standard rates which lurk in its dim depths—exceptions that are usually called special-interest provisions or, more bluntly, loopholes. (“Loophole,” as all fair-minded users of the word are ready to admit, is a

somewhat subjective designation, for one man's loophole may be another man's lifeline—or perhaps at some other time, the same man's lifeline.) Loopholes were noticeably absent from the original 1913 income-tax law. How they came to be law and why they remain law are questions involving politics and possibly metaphysics, but their actual workings are relatively simple, and are illuminating to watch. By far the simplest method of avoiding income taxes—at least for someone who has a large amount of capital at his disposal—is to invest in the bonds of states, municipalities, port authorities, and toll roads; the interest paid on all such bonds is unequivocally tax-exempt. Since the interest on high-grade tax-exempt bonds in recent years has run from three to five per cent, a man who invests ten million dollars in them can collect \$300,000 to \$500,000 a year tax-free without putting himself or his tax lawyer to the slightest trouble; if he had been foolish enough to sink the money in ordinary investments yielding, say, five per cent, he would have had a taxable income of \$500,000, and at the 1964 rate, assuming that he was single, had no other income, and did not avail himself of any dodges, he would have to pay taxes of almost \$367,000. The exemption on state and municipal bonds has been part of our income-tax law since its beginnings; it was based originally on Constitutional grounds and is now defended on the ground that the states and towns need the money. Most Secretaries of the Treasury have looked on the exemption with disfavor, but not one has been able to accomplish its repeal.

Probably the most important special-interest provision in the Code is the one that concerns capital gains. The staff of the Joint Economic Committee of Congress wrote in a report issued in 1961, "Capital gains treatment has become one of the most impressive loopholes in the federal revenue structure." What the provision says, in essence, is that a taxpayer who makes a capital investment (in real estate, a corporation, a block of stock, or whatever), holds on to it for at least six months, and then sells it at a profit is entitled to be taxed on the profit at a rate much lower than the rate on ordinary income; to be specific, the rate is half of that taxpayer's ordinary top tax rate or twenty-five per cent whichever is less. What this means to anyone whose income would normally put him in a very high tax bracket is obvious: he must find a way of getting as much as possible of that income in the form of capital gains. Consequently, the game of finding ways of converting ordinary income into capital gains has become very popular in the past decade or two. The game is often won without much of a struggle. On television one evening in the middle 1960s, David Susskind asked six assembled multimillionaires whether any of them considered tax rates a stumbling block on the highroad to wealth in America. There was a long silence, almost as if the notion were new to the multimillionaires, and then one of them, in the tone of some one explaining something to a child, mentioned the capital-gains provision and said that he didn't consider taxes much of a problem. There was no more discussion of high tax rates that night.

If the capital-gains provision resembles the exemption on certain bonds in that the advantages it affords are of benefit chiefly to the rich, it differs in other ways. It is by far the more accommodating of the two loopholes; indeed, it is a sort of mother loophole capable of spawning other loopholes. For example, one might think that a taxpayer would need to have capital before he could have a capital gain. Yet a way was discovered—and was passed into law in 1950—for him to get the gain before he has the capital. This is the stock-option provision. Under its terms, a corporation may give its executives the right to buy its shares at any time within a stipulated period—say, five years—at or near the open-market price at the time of the granting of the option; later on, if, as has happened so often, the market price of the stock goes sky-high, the executives may exercise their options to buy the stock at the old price, may sell it on the open market some time later at the new price, and may pay only capital-gains rates on the difference, provided that they go through these motions without

unseemly haste. The beauty of it all from an executive's point of view is that once the stock has gone up substantially in value, his option itself becomes a valuable commodity, against which he can borrow the cash he needs in order to exercise it; then, having bought the stock and sold it again, he can pay off his debt and have a capital gain that has arisen from the investment of no capital. The beauty of it all from the corporations' point of view is that they can compensate their executives partly in money taxable at relatively low rates. Of course, the whole scheme comes to nothing if the company's stock goes down, which does happen occasionally, or if it simply doesn't go up, but even then the executive has had a free play on the roulette wheel of the stock market, with a chance of winning a great deal and practically no danger of losing anything—something that the tax law offers no other group.

By favoring capital gains over ordinary income, the Code seems to be putting forward two very dubious notions—that one form of unearned income is more deserving than any form of earned income, and that people with money to invest are more deserving than people without it. Hardly anyone contends that the favored treatment of capital gains can be justified on the ground of fairness; those who consider this aspect of the matter are apt to agree with Hellerstein, who has written, “From a sociological viewpoint, there is a good deal to be said for more severe taxation of profit from appreciation in the value of property than from personal-service income.” The defense, then, is based on other grounds. For one, there is a respectable economic theory that supports a complete exemption of capital gains from income tax, the argument being that whereas wages and dividends or interest from investments are fruits of the capital tree, and are therefore taxable income, capital gains represent the growth of the tree itself, and are therefore not income at all. This distinction is actually embedded in the tax laws of some countries—most notably in the tax law of Britain, which in principle did not tax capital gains until 1964. Another argument—this one purely pragmatic—has it that the capital-gains provision is necessary to encourage people to take risks with their capital. (Similarly, the advocates of stock options say that corporations need them to attract and hold executive talent.) Finally, nearly all tax authorities are agreed that taxing capital gains on exactly the same basis as other income, which is what most reformers say ought to be done, would involve formidable technical difficulties.

Particular subcategories of the rich and the well-paid can avail themselves of various other avenues of escape, including corporate pension plans, which, like stock options, contribute to the solution of the tax problems of executives; tax-free foundations set up ostensibly for charitable and educational purposes, of which over fifteen thousand help to ease the tax burdens of their benefactors, though the charitable and educational activities of some of them are more or less invisible; and personal holding companies, which, subject to rather strict regulations, enable persons with very high incomes from personal services like writing and acting to reduce their taxes by what amounts to incorporating themselves. Of the whole array of loopholes in the Code, however, probably the most widely loathed is the percentage depletion allowance on oil. As the word “depletion” is used in the Code, it refers to the progressive exhaustion of irreplaceable natural resources, but as used on oilmen's tax returns, it proves to mean a miraculously glorified form of what is ordinarily called depreciation. Whereas a manufacturer may claim depreciation on a piece of machinery as a tax deduction only until he has deducted the original cost of the machine—until, that is, the machine is theoretically worthless from wear—an individual or corporate oil investor, for reasons that defy logical explanation, may go on claiming percentage depletion on a producing well indefinitely, even if this means that the original cost of the well has been recovered many times over. The oil-depletion allowance is 27.5 per cent a year up to a maximum of half of the oil investor's net income (there are

smaller allowances on other natural resources, such as 23 per cent on uranium, 10 per cent on coal, and 5 per cent on oyster and clam shells), and the effect it has on the taxable income of an oil investor, especially when it is combined with the effects of other tax-avoidance devices, is truly astonishing; for instance, over a recent five-year period one oilman had a net income of fourteen and a third million dollars, on which he paid taxes of \$80,000, or six-tenths of one per cent. Unsurprisingly, the percentage-depletion allowance is always under attack, but, also unsurprisingly, it is defended with tigerish zeal—so tigerish that even President Kennedy’s 1961 and 1963 proposals for tax revision, which, taken together, are generally considered the broadest program of tax reform ever put forward by a chief executive, did not venture to suggest its repeal. The usual argument is that the percentage-depletion allowance is needed in order to compensate oilmen for the risks involved in speculative drilling, and thus insure an adequate supply of oil for national use, but many people feel that this argument amounts to saying, “The depletion allowance is a necessary and desirable federal subsidy to the oil industry,” and thereby scuttles itself, since granting subsidies to individual industries is hardly the proper task of the income tax.

THE 1964 Revenue Act does practically nothing to plug the loopholes, but it does make them somewhat less useful, in that the drastic reduction of the basic rates on high incomes has probably led some high-bracket taxpayers simply to quit bothering with the less convenient or effective of the dodges. Insofar as the new bill reduces the disparity between the Code’s promises and its performance, that is, it represents a kind of adventitious reform. (One way to cure *all* income-tax evasion would be to repeal the income tax.) However, quite apart from the sophistry—since 1964 happily somewhat lessened—that the Code embodies, it has certain discernible and disturbing characteristics that have not been changed and may be particularly hard to change in the future. Some of them have to do with its methods of allowing and disallowing deductions for travel and entertainment expenses by persons who are in business for themselves, or by persons who are employed but are not reimbursed for their business expenses—deductions that were estimated fairly recently at between five and ten billion dollars a year, with a resulting reduction in federal revenue of between one and two billion. The travel-and-entertainment problem—or the T & E problem, as it is customarily called—has been around a long time, and has stubbornly resisted various attempts to solve it. One of the crucial points in T & E history occurred in 1930, when the courts ruled that the actor and songwriter George M. Cohan—and therefore anyone else—was entitled to deduct his business expenses on the basis of a reasonable estimate even if he could not produce any proof of having paid that sum or even produce a detailed accounting. The Cohan rule, as it came to be called, remained in effect for more than three decades, during which it was invoked every spring by thousands of businessmen as ritually as Moslems turn toward Mecca. Over those decades, estimated business deductions grew like kudzu vines as the estimators became bolder, with the result that the Cohan rule and other flexible parts of the T & E regulations were subjected to a series of attacks by would-be reformers. Bills that would have virtually or entirely eliminated the Cohan rule were introduced in Congress in 1951 and again in 1959, only to be defeated—in one case, after an outcry that T & E reform would mean the end of the Kentucky Derby—and in 1961 President Kennedy proposed legislation that not only would have swept aside the Cohan rule but, by reducing to between four and seven dollars a day the amount that a man could deduct for food and beverages, would have all but put an end to the era of deductibility in American life. No such fundamental social change took place. Loud and long wails of anguish instantly arose, from businessmen and also from hotels, restaurants, and night clubs, and many of the Kennedy proposals were soon abandoned. Nevertheless,

through a series of amendments to the Code passed by Congress in 1962 and put into effect by a set of regulations issued by the Internal Revenue Service in 1963, they did lead to the abrogation of the Cohan rule, and the stipulation that, generally speaking, all business deductions, no matter how small, would thenceforward have to be substantiated by records, if not by actual receipts.

Yet even a cursory look at the law as it has stood since then shows that the new, reformed T & E rules fall somewhat short of the ideal—that, in fact, they are shot through with absurdities and underlaid by a kind of philistinism. For travel to be deductible, it must be undertaken primarily for business rather than for pleasure and it must be “away from home”—that is to say, not merely commuting. The “away-from-home” stipulation raises the question of where home is, and leads to the concept of a “tax home,” the place one must be away from in order to qualify for travel deductions; a businessman’s tax home, no matter how many country houses, hunting lodges, and branch offices he may have, is the general area—not just the particular building, that is—of his principal place of employment. As a result, marriage partners who commute to work in two different cities have separate tax homes, but, fortunately, the Code continues to recognize their union to the extent of allowing them the tax advantages available to other married people; although there have been tax marriages, the tax divorce still belongs to the future.

As for entertainment, now that the writers of I.R.S. regulations have been deprived of the far-reaching Cohan rule, they are forced to make distinctions of almost theological nicety, and the upshot of the distinctions is to put a direct premium on the habit—which some people have considered all too prevalent for many years anyhow—of talking business at all hours of the day and night, and in all kinds of company. For example, deductions are granted for the entertainment of business associates at night clubs, theatres, or concerts only if a “substantial and bona fide business discussion” takes place before, during, or after the entertainment. (One is reluctant to picture the results if businessmen take to carrying on business discussions in great numbers during plays or concerts.) On the other hand, a businessman who entertains another in a “quiet business setting,” such as a restaurant with no floor show, may claim a deduction even if little or no business is actually discussed, as long as the meeting has a business purpose. Generally speaking, the noisier and more confusing or distracting the setting, the more business talk there must be; the regulations specifically include cocktail parties in the noisy-and-distracting category, and, accordingly, require conspicuous amounts of business discussion before, during, or after them, though a meal served to a business associate at the host’s home may be deductible with no such discussion at all. In the latter case, however, as the J. K. Lasser Tax Institute cautions in its popular guide “Your Income Tax,” you must “be ready to prove that your motive ... was commercial rather than social.” In other words, to be on the safe side, talk business anyhow. Hellerstein has written, “Henceforth, tax men will doubtless urge their clients to talk business at every turn, and will ask them to admonish their wives not to object to shop talk if they want to continue their accustomed style of living.”

Entertainment on an elaborate scale is discouraged in the post-1963 rules, but, as the Lasser booklet notes, perhaps a little jubilantly, “Congress did not specifically put into law a provision barring lavish or extravagant entertainment.” Instead, it decreed that a businessman may deduct depreciation and operating expenses on an “entertainment facility”—a yacht, a hunting lodge, a swimming pool, a bowling alley, or an airplane, for instance—provided he uses it more than half the time for business. In a booklet entitled “Expense Accounts 1963,” which is one of many publications for the guidance of tax advisers that are issued periodically by Commerce Clearing House, Inc., the rule was explained by means of the following example:

A yacht is maintained ... for the entertainment of customers. It is used 25% of the time for relaxation... Since the yacht is used 75% of the time for business purposes, it is used primarily for the furtherance of the taxpayer's business and 75% of the maintenance expenses ... are deductible entertainment facility expenses. If the yacht had been used only 40% for business, no deduction would be allowed.

The method by which the yachtsman is to measure business time and pleasure time is not prescribed. Presumably, time when the yacht is in drydock or is in the water with only her crew aboard would count as neither, though it might be argued that the owner sometimes derives pleasure simply from watching her swing at anchor. The time to be apportioned, then, must be the time when he and some guests are aboard her, and perhaps his most efficient way of complying with the law would be to install two stopwatches, port and starboard, one to be kept running during business cruising and the other during pleasure cruising. Perhaps a favoring westerly might speed a social cruise home an hour early, or a September blow delay the last leg of a business cruise, and thus tip the season's business time above the crucial fifty-percent figure. Well might the skipper pray for such timely winds, since the deductibility of his yacht could easily double his after-tax income for the year. In short, the law is nonsense.

Some experts feel that the change in T & E regulations represents a gain for our society because quite a few taxpayers who may have been inclined to fudge a bit under general provisions like the Cohan rule do not have the stomach or the heart to put down specific fraudulent items. But what has been gained in the way of compliance may have been lost in a certain debasement of our national life. Scarcely ever has any part of the tax law tended so energetically to compel the commercialization of social intercourse, or penalized so particularly the amateur spirit, which, Richard Hofstadter declares in his book "Anti-Intellectualism in American Life," characterized the founders of the republic. Perhaps the greatest danger of all is that, by claiming deductions for activities that are technically business but actually social—that is, by complying with the letter of the law—a man may cheapen his life in his own eyes. One might argue that the founders, if they were alive today, would scornfully decline to mingle the social and the commercial, the amateur and the professional, and would disdain to claim any but the most unmistakable expenses. But, under the present tax laws, the question would be whether they could afford such a lordly overpayment of taxes, or should even be asked to make the choice.

IT has been maintained that the Code discriminates against intellectual work, the principal evidence being that while depreciation may be claimed on all kinds of exhaustible physical property and depletion may be claimed on natural resources, no such deductions are allowed in the case of exhaustion of the mental or imaginative capacities of creative artists and inventors—even though the effects of brain fag are sometimes all too apparent in the later work and incomes of such persons. (It has also been argued that professional athletes are discriminated against, in that the Code does not allow for depreciation of their bodies.) Organizations like the Authors League of America have contended, further, that the Code is unfair to authors and other creative people whose income, because of the nature of their work and the economics of its marketing, is apt to fluctuate wildly from year to year, so that they are taxed exorbitantly in good years and are left with too little to tide them over bad years. A provision of the 1964 bill intended to take care of this situation provided creative artists, inventors, and other receivers of sudden large income with a four-year averaging formula to ease the tax bite of a windfall year.

But if the Code *is* anti-intellectual, it is probably so only inadvertently—and is certainly so only inconsistently. By granting tax-exempt status to charitable foundations, it facilitates the award of millions of dollars a year—most of which would otherwise go into the government's coffers—to

scholars for travel and living expenses while they carry out research projects of all kinds. And by making special provisions in respect to gifts of property that has appreciated in value, it has—whether advertently or inadvertently—tended not only to force up the prices that painters and sculptors receive for their work but to channel thousands of works out of private collections and into public museums. The mechanics of this process are by now so well known that they need be merely outlined: a collector who donates a work of art to a museum may deduct on his income-tax return the fair value of the work at the time of the donation, and need pay no capital-gains tax on any increase in its value since the time he bought it. If the increase in value has been great and the collector's tax bracket is very high, he may actually come out ahead on the deal. Besides burying some museums under such an avalanche of bounty that their staffs are kept busy digging themselves out, these provisions have tended to bring back into existence that lovable old figure from the pre-tax past, the rich dilettante. In recent years, some high-bracket people have fallen into the habit of making serial collections—Post-Impressionists for a few years, perhaps, followed by Chinese jade, and then by modern American painting. At the end of each period, the collector gives away his entire collection, and when the taxes he would otherwise have paid are calculated, the adventure is found to have cost him practically nothing.

The low cost of high-income people's charitable contributions, whether in the form of works of art or simply in the form of money and other property, is one of the oddest fruits of the Code. Of approximately five billion dollars claimed annually as deductible contributions on personal income-tax returns, by far the greater part is in the form of assets of one sort or another that have appreciated in value, and comes from persons with very high incomes. The reasons can be made clear by a simple example: A man with a top bracket of 20 per cent who gives away \$1,000 in cash incurs a net cost of \$800. A man with a top bracket of 60 per cent who gives away the same sum in cash incurs a net cost of \$400. If, instead, this same high-bracket man gives \$1,000 in the form of stock that he originally bought for \$200, he incurs a net cost of only \$200. It is the Code's enthusiastic encouragement of large-scale charity that has led to most of the cases of million-dollar-a-year men who pay no tax at all; under one of its most peculiar provisions, anyone whose income tax and contributions combined have amounted to nine-tenths or more of his taxable income for eight out of the ten preceding years is entitled by way of reward to disregard in the current year the usual restrictions on the amount of deductible contributions, and can escape the tax entirely.

Thus the Code's provisions often enable mere fiscal manipulation to masquerade as charity, substantiating a frequent charge that the Code is morally muddleheaded, or worse. The provisions also give rise to muddleheadedness in others. The appeal made by large fund-raising drives in recent years, for example, has been uneasily divided between a call to good works and an explanation of the tax advantages to the donor. An instructive example is a commendably thorough booklet entitled "Greater Tax Savings ... A Constructive Approach," which was used by Princeton in a large capital-funds drive. (Similar, not to say nearly identical, booklets have been used by Harvard, Yale, and many other institutions.) "The responsibilities of leadership are great, particularly in an age when statesmen, scientists, and economists must make decisions which will almost certainly affect mankind for generations to come," the pamphlet's foreword starts out, loftily, and goes on to explain, "The chief purpose of this booklet is to urge all prospective donors to give more serious thought to the manner in which they make their gifts.... There are many different ways in which substantial gifts can be made at comparatively low cost to the donor. It is important that prospective donors acquaint themselves with these opportunities." The opportunities expounded in the subsequent pages include ways of saving on taxes through gifts of appreciated securities, industrial property, leases, royalties,

jewelry, antiques, stock options, residences, life insurance, and inventory items, and through the use of trusts (“The trust approach has great versatility”). At one point, the suggestion is put forward that, instead of actually giving anything away, the owner of appreciated securities may wish to *sell* them to Princeton, for cash, at the price he originally paid for them; this might appear to the simple-minded to be a commercial transaction, but the booklet points out, accurately, that in the eyes of the Code the difference between the securities’ current market value and the lower price at which they are sold to Princeton represents pure charity, and is fully deductible as such. “While we have laid heavy emphasis on the importance of careful tax planning,” the final paragraph goes, “we hope no inference will be drawn that the thought and spirit of giving should in any way be subordinated to tax considerations.” Indeed it should not, nor need it be; with the heavy substance of giving so deftly minimized, or actually removed, its spirit can surely fly unrestrained.

ONE of the most marked traits of the Code—to bring this ransacking of its character to a close—is its complexity, and this complexity is responsible for some of its most far-reaching social effects; it is a virtual necessity for many taxpayers to seek professional help if they want to minimize their taxes legally, and since first-rate advice is expensive and in short supply, the rich are thereby given still another advantage over the poor, and the Code becomes more undemocratic in its action than it is in its provisions. (And the fact that fees for tax advice are themselves deductible means that tax advice is one more item on the long list of things that cost less and less to those who have more and more.) All the free projects of taxpayer education and taxpayer assistance offered by the Internal Revenue Service—and they are extensive and well meant—cannot begin to compete with the paid services of a good independent tax expert, if only because the I.R.S., whose first duty is to collect revenue, is involved in an obvious conflict of interest when it sets about explaining to people how to avoid taxes. The fact that about half of all the revenue derived from individual returns for 1960 came from adjusted gross incomes of \$9,000 or less is not attributable entirely to provisions of the Code; in part, it results from the fact that low-income taxpayers cannot afford to be shown how to pay less.

The huge army of people who give tax advice—“practitioners,” they are called in the trade—is a strange and disturbing side effect of the Code’s complexity. The exact size of this army is unknown, but there are a few guideposts. By a recent count some eighty thousand persons, most of them lawyers, accountants, and former I.R.S. employees, held cards, granted by the Treasury Department, that officially entitle them to practice the trade of tax adviser and to appear as such before the I.R.S.; in addition, there is an uncounted host of unlicensed, and often unqualified, persons who prepare tax returns for a fee—a service that anyone may legally perform. As for lawyers, the undisputed plutocrats, if not the undisputed aristocrats, of the tax-advice industry, there is scarcely a lawyer in the country who is not concerned with taxes at one time or another during a year’s practice, and every year there are more lawyers who are concerned with nothing else. The American Bar Association’s taxation section, composed mostly of nothing-but-tax lawyers, has some nine thousand members; in the typical large New York law firm one out of five lawyers devotes all of his time to tax matters; and the New York University Law School’s tax department, an enormous brood hen for the hatching of tax lawyers, is larger than the whole of an average law school. The brains that go into tax avoidance, which are generally recognized as including some of the best legal brains extant, constitute a wasted national resource, it is widely contended—and this contention is cheerfully upheld by some leading tax lawyers, who seem only too glad to affirm, first, that their mental capacities are indeed exceptional, and, second, that these capacities are indeed being squandered on trivia. “The law has its cycles,” one of them explained recently. “In the United States, the big thing until about 1890 was

property law. Then came a period when it was corporation law, and now it's various specialties, of which the most important is taxes. I'm perfectly willing to admit that I'm engaged in work that has a limited social value. After all, what are we talking about when we talk about tax law? At best, only the question of what an individual or a corporation should fairly pay in support of the government. All right, why do I do tax work? In the first place, it's a fascinating intellectual game—along with litigation, probably the most intellectually challenging branch of the law as it is now practiced. In the second place, although it's specialized in one sense, in another sense it isn't. It cuts through every field of law. One day you may be working with a Hollywood producer, the next day with a big real-estate man, the next with a corporation executive. In the third place, it's a highly lucrative field."

HYPOCRITICALLY egalitarian on the surface and systematically oligarchic underneath, unconscionably complicated, whimsically discriminatory, specious in its reasoning, pettifogging in its language, demoralizing to charity, an enemy of discourse, a promoter of shop talk, a squanderer of talent, a rock of support to the property owner but a weighty onus to the underpaid, an inconstant friend to the artist and scholar—if the national mirror-image is all these things, it has its good points as well. Certainly no conceivable income-tax law could please everybody, and probably no equitable one could entirely please anybody; Louis Eisenstein notes in his book "The Ideologies of Taxation," "Taxes are a changing product of the earnest effort to have others pay them." With the exception of its more flagrant special-interest provisions, the Code seems to be a sincerely written document—at worst misguided—that is aimed at collecting unprecedented amounts of money from an unprecedentedly complex society in the fairest possible way, at encouraging the national economy, and at promoting worthy undertakings. When it is intelligently and conscientiously administered, as it has been of late, our national income-tax law is quite possibly as equitable as any in the world.

But to enact an unsatisfactory law and then try to compensate for its shortcomings by good administration is, clearly, an absurd procedure. One solution that is more logical—to abolish the income tax—is proposed chiefly by some members of the radical right, who consider any income tax Socialistic or Communistic, and who would have the federal government simply stop spending money, though abolition is also advanced, as a theoretical ideal rather than as a practical possibility, by certain economists who are looking around for alternative ways of raising at least a significant fraction of the sums now produced by the income tax. One such alternative is a value-added tax, under which manufacturers, wholesalers, and retailers would be taxed on the difference between the value of the goods they bought and that of the goods they sold; among the advantages claimed for it are that it would spread the tax burden more evenly through the productive process than a business-income tax does, and that it would enable the government to get its money sooner. Several countries, including France and Germany, have value-added taxes, though as supplements rather than alternatives to income taxes, but no federal tax of the sort is more than remotely in prospect in this country. Other suggested means of lightening the burden of the income tax are to increase the number of items subject to excise taxes, and apply a uniform rate to them, so as to create what would amount to a federal sales tax; to increase user taxes, such as tolls on federally owned bridges and recreation facilities; and to enact a law permitting federal lotteries, like the lotteries that were permitted from colonial times up to 1895, which helped finance such projects as the building of Harvard, the fighting of the Revolutionary War, and the building of many schools, bridges, canals, and roads. One obvious disadvantage of all these schemes is that they would collect revenue with relatively little regard to ability to pay, and for this reason or others none of them stand a chance of being enacted in the foreseeable future.

A special favorite of theoreticians, but of hardly anyone else, is something called the expenditure tax—the taxing of individuals on the basis of their total annual expenditures rather than on their income. The proponents of this tax—diehard adherents of the economics of scarcity—argue that it would have the primary virtue of simplicity; that it would have the beneficial effect of encouraging savings; that it would be fairer than the income tax, because it would tax what people took out of the economy rather than what they put into it; and that it would give the government a particularly handy control instrument with which to keep the national economy on an even keel. Its opponents contend that it wouldn't really be simple at all, and would be ridiculously easy to evade; that it would cause the rich to become richer, and doubtless stingier as well; and, finally, that by putting a penalty on spending it would promote depression. In any event, both sides concede that its enactment in the United States is not now politically practicable. An expenditure tax was seriously proposed for the United States by Secretary of the Treasury Henry Morgenthau, Jr., in 1942, and for Britain by a Cambridge economist (later a special adviser to the National Treasury) named Nicholas Kaldor, in 1951, though neither proponent asked for repeal of the income tax. Both proposals were all but unanimously hooted down. “The expenditure tax is a beautiful thing to contemplate,” one of its admirers said recently. “It would avoid almost all the pitfalls of the income tax. But it's a dream.” And so it is, in the Western world; such a tax has been put in effect only in India and Ceylon.

With no feasible substitute in sight, then, the income tax seems to be here to stay, and any hope for better taxation seems to lie in its reform. Since one of the Code's chief flaws is its complexity, reform might well start with that. Efforts at simplification have been made with regularity since 1943, when Secretary Morgenthau set up a committee to study the subject, and there have been occasional small successes; simplified instructions, for example, and a shortened form for taxpayers who wish to itemize deductions but whose affairs are relatively uncomplicated were both introduced during the Kennedy administration. Obviously, though, these were mere guerrilla-skirmish victories. One obstacle to any victory more sweeping is the fact that many of the Code's complexities were introduced in no interest other than that of fairness to all, and apparently cannot be removed without sacrificing fairness. The evolution of the special family-support provisions provides a striking example of how the quest for equity sometimes leads straight to complexity. Up to 1948, the fact that some states had and some didn't have community-property laws resulted in an advantage to married couples in the community-property states; those couples, and those couples only, were allowed to be taxed as if their total income were divided equally between them, even though one spouse might actually have a high income and the other none at all. To correct this clear-cut inequity, the federal Code was modified to extend the income-dividing privilege to all married persons. Even apart from the resulting discrimination against single persons without dependents—which remains enshrined and unchallenged in the Code today—this correction of one inequity led to the creation of another, the correction of which led to still another; before the Chinese-box sequence was played out, account had been taken of the legitimate special problems of persons who had family responsibilities although they were not married, then of working wives with expenses for child care during business hours, and then of widows and widowers. And each change made the Code more complex.

The loopholes are another matter. In their case, complexity serves not equity but its opposite, and their persistent survival constitutes a puzzling paradox; in a system under which the majority presumably makes the laws, tax provisions that blatantly favor tiny minorities over everybody else would seem to represent the civil-rights principle run wild—a kind of anti-discrimination program for the protection of millionaires. The process by which new tax legislation comes into being—an original proposal from the Treasury Department or some other source, passage in turn by the House

Ways and Means Committee, the whole House, the Senate Finance Committee, and the whole Senate, followed by the working out of a House-Senate compromise by a conference committee, followed by repassage by the House and the Senate and, finally, followed by signing by the President—is indeed a tortuous one, at any stage of which a bill may be killed or shelved. However, though the public has plenty of opportunity to protest special-interest provisions, what public pressure there is is apt to be greater in favor of them than against them. In the book on tax loopholes called “The Great Treasury Raid,” Philip M. Stern points out several forces that seem to him to work against the enactment of tax-reform measures, among them the skill, power, and organization of the anti-reform lobbies; the diffuseness and political impotence of the pro-reform forces within the government; and the indifference of the general public, which expresses practically no enthusiasm for tax reform through letters to congressmen or by any other means, perhaps in large part because it is stunned into incomprehension and consequent silence by the mind-boggling technicality of the whole subject. In this sense, the Code’s complexity is its impenetrable elephant hide. Thus the Treasury Department, which, as the agency charged with collecting federal revenues, has a natural interest in tax reform, is often left, along with a handful of reform-minded legislators, like Senators Paul H. Douglas of Illinois, Albert Gore of Tennessee, and Eugene J. McCarthy of Minnesota, on a lonely and indefensible salient.

OPTIMISTS believe that some “point of crisis” will eventually cause specially favored groups to look beyond their selfish interests, and the rest of the country to overcome its passivity, to such an extent that the income tax will come to give back a more flattering picture of the country than it does now. When this will happen, if ever, they do not specify. But the general shape of the picture hoped for by some of those who care most about it is known. The ideal income tax envisioned for the far future by many reformers would be characterized by a short and simple Code with comparatively low rates and with a minimum of exceptions to them. In its main structural features, this ideal tax would bear a marked resemblance to the 1913 income tax—the first ever to be put in effect in the United States in peacetime. So if the unattainable visions of today should eventually materialize, the income tax would be just about back where it started.