Caplin Calls for Fairness and Simplification in New Tax Legislation

Former IRS Commissioner Mortimer M. Caplin of Caplin & Drysdale, Washington, presented the following testimony to a February 14 House Ways and Means Committee hearing on President Bush's tax relief proposals.

My name is Mortimer Caplin, a member of the Washington law firm of Caplin & Drysdale. I served as U.S. Commissioner of Internal Revenue from 1961 through 1964, during the Kennedy and Johnson years, and have specialized in the study and practice of tax law for some 50 years — as a professor at the University of Virginia School of Law, and as a lawyer representing a wide variety of business and individual taxpayers.

With a $5.6 trillion budget surplus projected for the coming decade, and with the president and both parties poised to enact sizable tax cuts, we are at a rare political moment — one that enables us to undertake a major overhaul of our tax structure, as well as to greatly simplify tax returns, reduce rates, and make tax laws fairer.

"Simplification" and "fairness" need to be at the heart of any new proposal for broad tax legislation. By combining such a focused perspective in conjunction with a broad-based/low graduated rate tax system, Congress will give American taxpayers unprecedented relief and, at the same time, will help revitalize public faith in how we run our government.

Our tax laws today are riddled with an array of targeted tax preferences and so-called incentives — grievously complicating tax compliance, eroding our tax base and thus necessitating increased tax rates to meet revenue demands. The federal tax code is replete with special deductions and credits, exemptions and exclusions, deferrals and other preferred treatment for particular industries, groups, or interests. Such provisions constitute a strong brew often leading to distortion of normal decisionmaking and encouragement of tax-motivated, noneconomic behavior. Tax avoidance and abuse are inevitable byproducts.

That these common techniques — typically justified on a variety of high-sounding grounds — are simply tax reductions for one anointed body or other, was candidly revealed by Treasury Secretary Paul H. O'Neill at his recent Senate Finance Committee confirmation hearings. In response to suggestions that business tax incentives might be good for our economy, Secretary O'Neill answered: "As a businessman I never made an investment decision based on the tax code. If you give money away I will take it, but good business people don't do things because of inducements."

Indeed, both as a former IRS Commissioner and as a practicing lawyer, I have found most businessmen's attitude on tax incentives entirely in line with that of Mr. O'Neill. How true is the observation that our tax laws reflect "a continuing struggle among contending interests for the privilege of paying the least."

Beyond this, we continue to see excessive manipulation of the tax laws to promote discrete social or economic objectives. The result: further fueling of taxpayer frustration from added complexities, tax base erosion, and resulting tax increases. All too often, Congress finds this "backdoor financing" route significantly more convenient, albeit more revenue costly, than the better-monitored process of direct appropriations.

Many taxpayers feel left out, discriminated against, and abused. Their respect for the tax system is repeatedly undermined; they are less willing to comply. And when weakening occurs in voluntary compliance — which is at the very heart of our tax collection process — our nation pays a high price.

With major tax reductions before us, a unique opportunity presents itself to sweepingly simplify tax reporting, ease tax administration, and restore taxpayer confidence in the entire system. Enacting the following changes would put these goals well within our reach:

1. Focus on tax return simplification, eliminating as many complexities as possible within reasonable revenue costs.
2. Restore a straightforward rate structure, minimizing the hidden rate increases imposed by "floors," "bubbles," "phaseouts," "clawbacks," and the like.
3. Eliminate the bulk of special preferences, broadening the tax base significantly.
4. Tax capital gains in the same manner as ordinary income.
5. Repeal the alternative minimum tax (AMT) for individuals as well as corporations, offsetting the enlargement of the tax base.
6. Lower all graduated rates across the board.

We as a people would be better served by a broad-based/low graduated rate tax system, with only the most limited of tax favors. Such a regime — aimed at treating all forms of income alike, and providing equal tax treatment for persons with equivalent dollar incomes — would clearly be simpler, fairer, and more equitable for our citizenry at large.

With the new administration primed for major tax changes, Congress should boldly move forward on the path first carved out by President Reagan's Tax Reform Act of 1986. In addition, steps must be taken to correct some of the undue restraints imposed on the IRS by the Internal Revenue Service Restructuring and Reform Act of 1998.

Widespread publicity is currently being given to (1) blatant examples of outright flouting of the tax laws, and (2) the disturbing and critical drop in the number of tax returns the IRS examined in fiscal 2000 — less than one-half of 1 percent of returns filed, and about 50 percent less than the percentage examined in 1999. Compliance and confidence in the tax system obviously suffers seriously by this weakening of enforcement.

Taxpayers want assurance that their neighbors down the street are paying their proper share of taxes; and it is, indeed, shortsighted to pass new tax laws without providing the IRS the manpower and resources to carry them out in a fair and reasonable fashion. Congress will certainly make sure that this proper balance is maintained in any new legislation enacted.[1]

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[1]This testimony is based in part on my article, "Now Is the Time to Reform the Tax Code," which appeared in *The Wall Street Journal*, Feb. 7, 2001.