AN ANALYSIS OF THE FORMATION OF FEDERAL INCOME TAX POLICY

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INTRODUCTION

The Congress of the United States uses the federal income tax to satisfy several social and political goals. One of those goals is to raise revenues sufficient to defray government expenditures incurred in providing services.1 Another goal is to stimulate and regulate economic activity.2 A third goal, one which has been more frequently implemented in the past thirty years, is to strive for social justice by using tax incentives.3

Tax law4 is primarily promulgated by Congress. While other tax

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1. Arguably, this is the primary function of the income tax. The authority for Congress to levy the tax is found in the 16th Amendment to the U.S. Constitution. U.S. CONST. amend. XVI: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

2. The primary tools used by the Congress in such activities are incentive and/or disincentive provisions of the Internal Revenue Code of 1954. There is a wealth of empirical literature investigating the effectiveness of incentives such as the investment credit, I.R.C. § 38, accelerated depreciation, I.R.C. §§ 167-168, and the immediate expensing of a portion of the cost of capital goods, I.R.C. § 179. See, e.g., N. TURE, ACCELERATED DEPRECIATION IN THE UNITED STATES, 1954-60 (1967); Brown, Tax Incentives for Investment, 52 AM. ECON. REV. 335 (1962); Fieldstein, Adjusting Depreciation in an Inflationary Economy: Indexation v. Acceleration, 34 NAT'L TAX J. 29 (1981); Hall and Jorgenson, Tax Policy and Investment Behavior, 57 AM. ECON. REV. 391 (1967); Hicks, Choosing the Form for Business Tax Incentives, 53 THE ACCT. REV. 708 (1978); Raboy, Depreciation Policy and Economic Efficiency, 17 BUS. ECON. 35 (1982); Sunley, Toward a More Neutral Investment Tax Credit, 26 NAT'L TAX J. 209 (1973). For a proposal concerning a policy shift, see Fisher, Investment Tax Credits, Capital Gains Taxation, and Reindustrialization of the U.S. Economy, 15 J. ECON. ISSUES 769 (1982).


4. The sources of tax law include the I.R.C. decisions of federal courts (U.S.
actors—the President, the Federal Courts, the IRS, taxpayers, and taxpayers' advisers—all have an impact on the tax law, in the final analysis, the Congress is responsible for the configuration of the Internal Revenue Code (Code) at any given time.

In passing the tax legislation which becomes the Code, Congress acts in a political fashion. In this regard, members of Congress are subject to all the political pressures inherent in a free, democratic, representative system of government. Individual taxpayers may petition their representatives for favorable legislation. Taxpayers may also form interest groups in an attempt to more effectively represent a given constituency. The groups will petition congressional members, and many times two or more organizations will propose different treatment for their respective memberships. Congress must then deal with these competing interests and choose that set of alternatives which best meets the needs of the country, as the membership of Congress individually and collectively perceives those needs.

In making these political choices, Congress forms tax policy. In the broad sense, all tax actors can have a policy about taxes. However, since Congress is constitutionally responsible for raising revenue, its tax policy is more significant than that of other tax actors. The policies of other actors are important to the extent they influence Congress. The policy of Congress is important because it provides structure for the entire system. The legislation which Congress passes (or chooses not to pass) is the clearest enunciation of its tax policy. Since Congress is primarily responsible for tax policy, it must also bear responsibility for the effects of that policy on the social, political, and economic sectors of society.

One result of the political process inherent in the formation of tax law is the dissatisfaction individual taxpayers feel when confronting the results of legislative action which are different from those they desired or anticipated. As this dissatisfaction grows, it can result in total alienation, with taxpayers perceiving themselves as victims of a system which theoretically is designed to serve them. As alienation increases, so too does the temptation to circumvent the system. This circumvention can range from understatement of income and/or overstatement of deductions, to refusal to file a return, to outright fraud. Some taxpayers who practice this form of tax pro-

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5. See notes 31-32 and accompanying text infra for an expanded discussion of “policy” and the role various tax actors play in forming tax policy.

test justify their actions by contending that the system is inequitable and unfair. Others who underreport are to some extent lulled by the voluntary nature of the system and the inability of the Treasury to exact complete compliance by all taxpayers.

The purpose of this article is to identify the existing policy formation characteristics in the federal income tax system, to analyze how the system operates, and to suggest some implications from that operation. Some of the apparent results which will be suggested include the levels of noncompliance, the degree of complexity, the inconsistencies within the Code itself, and the attempt to satisfy several governmental goals with one social system. To the extent that these results are undesirable, the system should change, whether by internal means (by Congress) or external ones (taxpayers).

Accordingly, several options will be suggested which may have the result of minimizing these undesirable effects. Each will be analyzed to determine its potential for minimization. Specifically, this article proposes an Internal Revenue Code Convention to suggest changes in the present Code including: the use of holistic analysis techniques within the present system; the development of an expert agency, with more expansive legislative authority than the Internal Revenue Service, as the government “expert” in tax matters; and changes in the tax base and/or tax rate system to simplify the Code.

POLICY FORMATION CHARACTERISTICS OF THE FEDERAL INCOME TAX SYSTEM

The interaction of the several characteristics that exist in the federal income tax system forms a policy milieu. The choices made by the actors in the system in reaction to those characteristics thus determine the stated policy of the actor with regard to income tax for a given point in time. Extensive consideration of each of these characteristics before policy is set does not always occur. But some consideration is by implication given to each by the very fact of taking action and making choices about the system.

There are three major characteristics present in the system—goal orientation, constitutional constraints, and political constraints. The first and third of these are variable in nature; that is, there is significant potential variation in the configuration of the characteristic at a given time. The second characteristic is more rigid, and variations from its norm are slight and usually predicated by operation of one of the other two characteristics. Each will be discussed in the sections following.
GOAL ORIENTATION

Before the congressional or the executive branches can act, they must explicitly or implicitly make policy decisions, based on their perceptions of the electorate, as to the desired goals of the people. In other words, the elected official must make social welfare choices. A second set of decisions that must be made is the choice of alternative methods of meeting these goals. One of the alternatives is the medium for accomplishment, that is, whether the program should be a government sector or a private sector project. Another alternative is the method of funding—general taxation, excise tax, bond fund, user fees, government assisted private sector financing (such as industrial development bonds or tax relief), or full private financing.

If the federal government is to provide the service, then Congress must have the power to raise the revenue. Conversely, the electorate must realize that if it makes demands on government for services, it must be willing to provide the revenues.

This dichotomy is best illustrated by the present proposals for a balanced federal budget and for tax increases. For many years, Congress has determined that certain services should be provided by government. In recent times, the cost of these services has grown faster than the revenues Congress has been able to raise. The result has been significant deficits in the operation of the federal government. Recognizing this, one current debate focuses on whether Congress should have the power to operate at a deficit. Another debate centers on the size of, and who should bear, the income tax burden—a variation on the question of the appropriate amount of tax dollars Congress should raise. Both these current proposals are significant

7. A complete discussion of the process of decision making is beyond the scope of this article. For a more expansive treatment, see A. Goicoechea, D. Hansen, & L. Duckstein, Multiobjective Decision Analysis with Engineering and Business Applications (1982); E. Stokey & R. Zeckhauser, A Primer for Policy Analysis (1978); M. Zeley, Multiple Criteria Decision Making (1982).

8. The public debate on this issue is whether there should be a constitutional amendment mandating a balanced federal budget. See H. Hazlitt, The Inflation Crisis and How to Resolve It (1978); Ackley, You Can't Balance the Budget by Amendment, 25 Challenge 4 (Nov./Dec. 1982); Friedman, Less Red Ink, 251 Atlantic 18 (Feb. 1983).

9. Implicit in the analysis of who bears the income tax burden is the conclusion that the income tax is the proper base for spreading the federal tax burden among various elements of society. However, in recent years there has been an increase in proposals that the income tax be modified or abandoned as the primary federal tax base. For studies which include both burden analysis and tax base analysis, see generally Hearings on Flat Tax Rate Before the Senate Finance Committee, 97th Cong., 2d Sess., 28-30 (1982); Comprehensive Income Taxation (J. Pechman ed. 1977); W. Simon, Reforming the Income Tax System (1981); Tax Foundation, Consumption Tax: An Idea Whose Time Is Coming, Special Report (1983); Treasury Department, Blueprints for Basic Tax Reform (1977); What Should Be Taxed: Income or Ex-
because they provide evidence that taxpayers and policy makers recognize the limits of growth and the fundamental relationship between government services and government revenues.

As mentioned previously, the federal income tax is used to achieve many governmental goals. The primary use of the tax system is the provision of revenues for government so it can pay for the services desired by the people. Congress has many types of taxes which it can use to meet revenue needs, but by far the income tax provides the lion’s share of federal revenues. Other sources of funding include user fees and special assessments. Another source which is not traditionally considered a revenue, but which has tax and thus revenue effects, is deficit spending. In reality, the use of deficits by government is a tax on the income, property, and privileges of future generations. While it is beyond the scope of this paper to enter the debate on deficit spending, it is necessary from a tax policy viewpoint to remember this relationship between deficits and future taxes.

In choosing between various revenue measures, Congress must decide which is most appropriate for the service being provided. Congress is subconsciously, and sometimes consciously, guided by the general principles of taxation which were first observed by Adam Smith. He postulated that taxes must be fairly and equitably levied, that they must be neutral, and that they be efficiently levied and collected. Thus, the choice between the use of a tax or some other revenue measure also should be based on an analysis of efficiency, fairness, and administrative burden.

However, when Congress passes tax measures, it apparently does not analyze fully these equitable and administrative aspects. As a general rule, measures tend to stand or fall based on their revenue properties. While congressional language justifying the measure might be couched in terms of equity, fairness, or efficiency and administrative burden, the use of such language without sufficient re-
search or analysis to warrant such conclusions is misleading.

The continued use of equity and fairness language when the requisite, rigorous analysis has not been completed creates an unfortunate impression that the particular measure is the best alternative for the given need. If the legislation is later attacked, its defenders can raise the shibboleth of "equity" and "fairness" based on the statements made contemporaneously—in the legislative history and elsewhere—with the passage of the act. It is thus possible for inequity and unfairness to be legislatively enacted and defended by using equity and fairness arguments.

A second goal that the internal revenue system is used to satisfy is that of economic regulation. The income tax has been used to provide both incentives and disincentives for various economic activities. It has been used to stimulate and to dampen the intensity with which the economic system is operating at a given point in time. Understandably, there has been considerable debate about the efficacy of the income tax as a regulator of the economy. Indeed, some commentators have suggested that the income tax is not an effective regulatory tool in certain circumstances. These analysts propose that direct government grants of cash or privileges would be better than tax deductions or credits with regard to fostering certain actions.\textsuperscript{13}

Means Committee or the Senate Finance Committee used modern policy analysis tools to determine the actual burden, fairness, or equity implications of their proposals. There are references, but no citations, to the actual studies in the Committee Reports. However, there is very clearly included, in tabular form, the projected revenue effects of the proposed changes. See S. REP. No. 494, 97th Cong., 2d Sess. 3, reprinted in 1982 U.S. CODE CONG. & AD. NEWS 781, 869-74 (chart summarizing the revenue effects). See id. at 866 for a general statement that refers to equity studies. This Senate Report pertains to the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.) [hereinafter TEFRA]. See also S. REP. No. 144, 97th Cong., 1st Sess. 3, reprinted in U.S. CODE CONG. & AD. NEWS 105, 122-28 (illustration of revenue effects). See id. at 136-39 for a discussion of the marriage penalty, which contains a chart comparing the prior law with the changes made by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.) [hereinafter ERTA]. This discussion, however, does not develop the issues fully.

The provisions of tax bills proposed by the Executive are analyzed by the Treasury Department, specifically the Offices of Tax Analysis and Tax Legislative Counsel. These analyses are then used by the Secretary of the Treasury in his presentation to the House Ways and Means Committee. However, the analyses themselves are not necessarily included in any subsequent Committee Report. Furthermore, the public usually does not have any chance to object to the logic, comprehensiveness, and rigor of the analyses until after they have been (if in fact they are) presented as part of the Secretary’s report. See J. Pechman, Federal Tax Policy 39-43 (4th ed. 1983). Pechman suggests that an improvement in the tax legislative process would be to provide the public with these analyses before tax issues are considered legislatively. Id. at 54.

It is clear that Congress has used the Code for economic regulations in response to specific pressure to provide assistance to various interest groups. For example, the percentage depletion allowance has been part of tax law since the inception of the income tax.\textsuperscript{14} However, the application of the provision has expanded as interest groups have convinced Congress to give them the benefits of the deduction.\textsuperscript{15} As will be discussed this is a highly political process, one in which a complete analysis of the total impact on society is extremely difficult. Thus, the Code might be used to provide an incentive where none rationally should be provided. To the extent this occurs, the Code becomes appended with incentive provisions which are narrow, restrictive, and perhaps unwise.

In the past thirty years, the income has been used increasingly to foster social justice. The progressive nature of the tax rate system arguably lends itself to income redistribution from the wealthier segments of society to those less fortunate. This is an inherent aspect of a progressive system where the revenues are used to provide services to all and is defensible only if the majority of society feels that redistribution is fair and equitable. Obviously, if the majority of society has less wealth and income than a minority in terms of economic well-being, the majority will view redistribution as fair. However, in recent years, the effect of the progressive system apparently has been to tax more heavily the middle income levels rather than the upper. The result has not been the classic redistribution from high to low, but rather from middle to low.\textsuperscript{16} This has obviously led to much dissatisfaction by those middle income level taxpayers and has led to new cries for more equitable taxation at upper income levels. At the same time, two recent major tax bills, the Economic Recovery Tax Act of 1981 (ERTA) and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), which Congress passed and the President signed, have provided taxpayer relief which is more pronounced in


\textsuperscript{15} See 26 U.S.C.A. § 613, Historical Note, 267-72 (West 1954) for an illustration of the additions to the percentage depletion provisions which make allowance for various interest groups. See also Suchanek, supra note 14.

upper than middle income levels.\textsuperscript{17}

The income tax is also used to foster social justice by providing incentives or disincentives for various types of activity. For example, the income tax has been used to minimize racial discrimination,\textsuperscript{18} to aid the handicapped,\textsuperscript{19} to help clean the environment,\textsuperscript{20} and to stimulate exploration and exploitation of alternative energy sources such as solar and wind power.\textsuperscript{21} Conversely, the income tax itself is discriminatory in that it provides more favorable treatment for some segments of society than others. For example, the tax rate system discriminates based on marital status.\textsuperscript{22} Since the rate system is progressive in nature, it is perforce discriminatory in that those taxpay-
ers with greater income pay a larger proportionate amount of tax than taxpayers with less income.

Thus, the tax system contains both positive and negative effects on social justice. When a tax measure is suggested as a cure for some social ill, Congress must again compare the ability of the tax actually to provide the particular incentive with some other type of government action, i.e., direct grant and no government action at all or reliance on the private sector to determine the proper vehicle for providing for the social good sought. In addition, Congress must also decide initially, and the people through the election process must decide ultimately, whether the tax system as a whole and as presently configured has hindered or enhanced the provision of social justice for all members of society.

It is important to recognize that using the tax system to satisfy social goals other than revenue raising creates internal tensions which must be resolved. Providing tax incentives makes it more difficult to achieve desired revenue goals since incentives many times are revenue reducers. It is incumbent upon Congress, and if Congress is lax, upon congressional observers, to recognize this tension and its collateral effects and try to quantify the results. While these effects many times are difficult to discern, the attempt to identify them must be made. If Congress does not attempt to resolve the tension at the time tax legislation is passed, at a later time such resolution may be more difficult and entail significant costs.

This suggests that Congress should be very careful in deciding to use the tax system for goals other than revenue enhancing. It must first be very careful about deciding whether a particular social goal should be met through government action or left to the private sector. It then must make very difficult choices about whether government's involvement should be in the nature of direct expenditures, grants, or other types of fostering activity or should be in the nature of tax incentives. Congress must have a mechanism to identify and deal with the interrelationship of these various alternatives. As will be developed further, the holistic method is one tool which can satisfy this need.

CONSTITUTIONAL CONSTRAINTS

The Constitution grants Congress the exclusive power to make

28 PRAC. LAW. 77 (July 15, 1982). See also note 12 supra for the Senate Report on the penalty.

There are other forms of discrimination concerning marriage in the Code. See Richards, Discrimination Against Married Couples Under Present Income Tax Laws, 49 TAXES 526 (1971).
laws necessary to lay and collect taxes. Specifically, the House of Representatives has been given the power to initiate revenue bills. However, the Senate is able through various legislative mechanisms to force consideration of revenue and tax legislation by the House.

While the Congress has the exclusive power to pass legislation creating and imposing tax liability, other tax actors have an impact on the final shape that legislation takes. The Executive Branch proposes various legislative measures to the Congress. These legislative measures are designed to meet the specific goals of the President and/or the Treasury Department with regard to their perceptions of the usefulness of the income tax to meet the various social goals discussed above. The President has the veto power over all legislation, and this power imposes a potential threat for Congress with regard to tax legislation which is not favored by the President. However, the veto power has not been used in recent times to change extensively the configuration of tax legislation.

The judiciary has an interpretative power with regard to the Internal Revenue Code. It interprets cases and controversies which are brought before it. Since it cannot seek out controversies on its own initiative, tax policy set by the courts is generally in the nature of reaction to statutes already passed and enforced. These policies will be useful as guides for future action by taxpayers to the extent their situations fall within the ambit or penumbra of the particular ruling.

The courts' decisions set boundaries within which the various actors can operate. Both substantive and procedural matters are decided by the courts, and, thus, judicial rules may determine the manner in which the tax base is calculated as well as the mechanisms for collecting the tax. Taxpayers and the Treasury Department must abide by the decisions reached by the various courts. Congress, however, has the power, within limits, to change the boundaries set by the courts by changing the underlying legislation upon which the courts have acted. In these situations, Congress in effect exerts a de facto veto power over the courts.

25. The Senate acts on bills sent to it by the House. However, the rules for passage are different than in the House, and amendments to the bill may be made on the floor of the Senate. Thus, through the amendment process the Senate is able to in effect bring new revenue measures before the Congress. If the amendments are approved by the Senate, but not by the House, the bill is sent to a joint Conference Committee. See J. Pechman, supra note 12, at 48.
The Executive Branch has the responsibility for enforcing the laws made by Congress. The Treasury Department makes tax policy statements for the President and acts as a liaison between the President and the Congress on tax matters. Congress has given the Treasury the power to make regulations which both interpret the law as Congress has promulgated it and which fill the gaps and actually become the law where Congress has chosen to delegate law-making power.

One division of the Treasury Department is the Internal Revenue Service (IRS). The IRS has the Executive's chief enforcement responsibility. It administers tax law and helps ensure compliance by entities subject to the income tax. As a necessary prerequisite to enforcement, the IRS also acts to interpret tax law. The Service issues Revenue Rulings, Revenue Procedures, and Letter Rulings. Where necessary, it shares the actual burden of developing regulations with the Treasury.

The Service thus exerts a policy-type influence on taxpayers by changing the method and procedures which it uses to enforce the law and by its allocating of resources to enforcement activities. However, Congress can and will act to dampen the enthusiastic enforcement efforts of the IRS in areas where Congress feels the Service has overstepped its bounds.

222. Section 1 of the Act added I.R.C. § 456. In American the Supreme Court held that the Association, an accrual method taxpayer, could not spread prepaid dues over the period for which the Association was required to provide services. Id. at 693. The dues were taxed upon receipt. Id. at 689.

I.R.C. § 456 states that certain membership organizations (the definition would include the American Automobile Association) may spread prepaid dues received in taxable years beginning after December 31, 1960, over the period of service. The Senate Report addresses the issue at 1961 U.S. CODE CONG. & AD. NEWS 1287.

29. U.S. CONST. art. II.


31. For examples of congressional delegation of the power to make tax law (legislative regulations), see I.R.C. § 385 (authorizing Secretary of the Treasury to determine whether an interest in a corporation is to be treated for purposes of this title as stock or indebtedness). See also I.R.C. § 1502.

The taxpayer helps to chart the progress of tax policy by continued compliance with the tax law and active participation in the political process which elects Congress. The attitude which the taxpayer exhibits toward compliance determines to a great extent whether a particular controversy will be brought to light and how quickly it will be resolved. If taxpayers are aggressive in their interpretations, controversies with the IRS arise more quickly, are settled more expeditiously, and the effects are more widely disseminated. In the past twenty years, there have been institutional incentives for such actions. Recent legislation has created some disincentives; it will be interesting to observe whether the level of controversy changes in the future.3

While taxpayers exert a policy influence, the individual impact of any given taxpayer is minimal. Thus, taxpayers are by necessity forced to coalesce into interest groups which will be stronger and better able to catch and hold the attention of Congress with regard to particular situations. The impact of these interest groups will be discussed further.

Other than Congress, each of the actors discussed above has an indirect, advisory role in the formation of federal income tax policy. One analyst has chosen to define policy as a statement by a group

market value housing furnished to faculty (Deficit Reduction Act of 1984, § 531(g)), the Treasury now may promulgate regulations in this area.

33. Interest rates charged on deficiencies are now determined on a semi-annual basis, I.R.C. § 6621(b), as amended by TEFRA, § 345(a). In addition, interest is compounded on a daily basis, I.R.C. § 6622, added by TEFRA, § 344(a). The effect of these provisions is to give the Treasury the power to charge an interest rate close to the prime rate on deficiencies. Thus, there is now a disincentive for taking aggressive positions and underpaying taxes.

The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), [hereinafter cited as Tax Reform Act of 1976], § 1203(b)(1) added § 6694 to the Internal Revenue Code. TEFRA, § 324(a), added § 6701 to the IRC. TEFRA, § 323(a), added § 6661 to the Internal Revenue Code. Collectively, these new sections are known as the preparer penalties because they were aimed at negligent and fraudulent activity by tax return preparers. Before these provisions the major weapons the Treasury possessed were the criminal penalties of I.R.C. § 7201. Thus the new provisions limit to some extent the aggressiveness of tax return preparers. There is significant controversy concerning the efficacy of these provisions. See COMPTROLLER GENERAL, IRS’ ADMINISTRATION OF PENALTIES IMPOSED ON TAX RETURN PREPARERS, REPORT TO THE JOINT COMMITTEE ON TAXATION (1983), and Schnee, Bindon, & Ellis, The Policy Implications of and Experience with Preparer Penalties, Abstract in AM. ACCT. ASS’N ANN. MEETING 78 (1983).

TEFRA, § 326(a) added § 6702 to the Internal Revenue Code. This section imposes a penalty for the filing of frivolous tax returns, such as those which purport that no tax is due because the U.S. is no longer on the gold standard. This provision, and the substantial understatement provision of I.R.C. § 6661, added to the Internal Revenue Code by TEFRA, § 323(a), are aimed at taxpayers themselves in their activities which unreasonably understate tax liability. For an explanation of these provisions, see Raby, TEFRA: Impact on Taxpayer Compliance, J. ACCT. 64 (Nov. 1982).
about its future goals, actions, or aspirations. However, others suggest that policy is not just a verbal statement but action taken with reference to the statement. That is, the true policy of a group is not what it says it is going to do but what it actually does. It thus follows that since the only group which can take effective action on tax matters is Congress, only Congress can form the ultimate tax policy for the country. Other actors in effect react to congressional action. While they may have a policy about their reaction to Congress, their policy toward tax law must be a subset of the policy formed by Congress.

It should be noted that those called upon to enforce the Internal Revenue Code can have enforcement policies. Thus, the President, the Secretary of the Treasury, the Commissioner of the IRS, and the Courts can have biases and goals with regard to their enforcement activities. In one sense these can be called policies because the foregoing participants usually will act in conformity with their prior statements and taxpayers will know what to expect. Within constitutional constraints, however, these statements derive their validity from the acquiescence of Congress (and hence the people) in the course of action. Should these enforcement actions exceed the bounds that Congress perceives as fair, the authority of the particular agency to act will be rescinded.

POLITICAL CONSTRAINTS

When Congress acts, it perforce makes political choices. All congressional action is the result of trade-offs among various constituencies. Congress must constantly balance services to be provided with revenues to be raised and groups to be given incentives with groups from whom greater prices will be exacted. It thus must make choices based on what it perceives to be the most politically expedient course of action.

Members of Congress listen to their constituencies and try to make decisions based on their individual perceptions of the wishes of the majority of the people they represent. Since this is the case, it seems logical that, all things being equal, members of Congress will respond favorably to that person or group which appears to represent

36. For a general discussion of the way Congress works, see D. PALUMBO, AMERICAN POLITICS 186-227, 390-423 (1973). Logrolling, the process of trading votes in order to achieve a consensus, is described in BROWNING & BROWNING supra note 17, at 57-60 and in more detail in J. BUCHANAN & G. TULLOCK, THE CALCULUS OF CONSENT (1962).
the majority. All things are usually not equal, however, because of the need for Congress to pass laws which affect all people and groups. Thus trade-offs occur, which in reality is a situation where a member of Congress feels more pressure from another member than from his or her constituents. The result is that small groups with small constituencies can exert great pressure, thus imposing their will on the majority.

This situation is complicated by the existence of special interest groups and lobbyists which have become an integral part of the political system in the United States. These groups are able to exert much greater influence than particular or individual taxpayers because they are organized in such a manner to accomplish this result. Special interest groups are for the most part of two types—group oriented and issue oriented. The group oriented organizations represent a narrow constituency over a broad range of issues, whereas the issue organizations represent a broad constituency for a single or few issues.

Both types of groups are able to devote their resources to those particular legislative proposals which have a bearing on their area of concern. Since an interest group represents more than one individual, the ability to generate the resources necessary to mount a campaign to convince members of Congress to follow their particular viewpoint is made much easier.

The proliferation of special interest groups has resulted in more difficult choices for Congress because many issues have both opponents and proponents represented by these organizations. As a result, congressional action may result from compromises which satisfy the wishes of one or several interest groups while dissatisfying the wishes of the majority of the electorate. This phenomenon is directly related to the level of participation by individuals in the political process. Congress will bow to the wishes of a vociferous electorate, but if the electorate is a “silent majority,” it is difficult for Congress to

37. Of 26 special interest organizations which have significant or exclusive concerns with tax policy matters, 19 have been formed since 1965. Mele, Organizations Seeking To Influence Tax Policy, TAX NOTES 627 (Sept. 21, 1981). For a discussion of the growth in interest groups, as well as the impact of election financing changes and the growth of political action committees, see J. BERRY, THE INTEREST GROUP SOCIETY, (1984).

38. For example, the Chamber of Commerce of the United States, the American Medical Association, and the National Association of Manufacturers are all groups which represent the interests of their constituents over a broad range of issues.

39. For example, the National Rifle Association and Mothers Against Drunk Drivers are groups which represent the interests of their constituents with regard to the single issue for which they were formed.
discern its wishes and satisfy its desires.\textsuperscript{40}

Another result of the increase in the number of interest groups is legislation which is not consistent with prior statutes. This inconsistency can be of one or two types. The first is a purely technical inconsistency where the recently passed legislation either cannot be easily integrated into the existing United States Code or is in direct conflict with existing provisions. Major tax bills in recent years have been followed by technical corrections bills designed to make the language of the Code consistent between the existing law and the new provision and to resolve the conflicts and close the unintended "loop-holes" which were created by congressional action.\textsuperscript{41} These technical inconsistencies result because Congress acts in a political fashion, many times with politically motivated deadlines, and thus is not able to always resolve problems and minimize complexities before the legislation is passed.

The second type of inconsistency is at the goal level. When Congress passes legislation, it does so politically and expeditiously. Usually, it has neither the time nor the inclination to assess fully the impact of new proposals on the goals already chosen. It does consider revenue effects but too often does not analyze in-depth other effects to determine whether the attainment of enunciated goals will be hindered or enhanced by new legislation. Thus, the most recent congressional action may conflict with goals sought by prior Congresses, resulting in confusion for taxpayers, other tax actors, and policy analysts.

To summarize, federal income tax policy is formed by Congress in response to the concerns of its members and other tax policy actors. Congress is primarily responsible for both the policy and the results of the policy because of its position in the constitutional hierarchy. It acts in a political manner and thus is subject to all the

\textsuperscript{40} See L. DODD & R. SCHOTT, CONGRESS AND THE ADMINISTRATIVE STATE 106-54, 181-84 (1979).

problems and pressures of that process. Special interest groups have a great deal of influence with Congress and help determine the shape of tax policy. When Congress acts, it does so expeditiously; thus, many times inconsistencies exist between the legislation most recently passed and prior legislative action.

RESULTS IMPLICIT IN THE FORMATION OF FEDERAL INCOME TAX POLICY

The direct result of the system of income tax policy formation is the Internal Revenue Code itself and the revenue raised from enforcing it. Some indirect results include the extent to which incentives and disincentives for certain actions are successful in regulating the economy and promoting social justice. It appears, however, that there is another indirect result flowing from the formation process—the level of taxpayer noncompliance.

When citizens in general perceive that their government is not providing the services that they desire in the manner in which they desire, they become disillusioned and disenchanted with that government. When taxpayers perceive that the tax system is not living up to their expectations of equity and fairness with regard to the sharing of the tax burden, they not only become disillusioned and disenchanted, they sometimes take evasive action.

There will always be a certain segment of society which will choose not to cooperate with the tax system. It should not be surprising that those whose livelihood is based upon illegal earnings would opt not to be involved voluntarily with the tax system. However, as disillusionment with the tax system increases, it affects primarily the middle class—those taxpayers who have been the staunchest supporters of the system throughout its seventy year history. In recent years, a greater share of the tax burden has been shifted to this segment of society, causing widespread concern.42 Members of this

42. In 1970, households having adjusted gross income of at least $25,000 but less than $100,000 paid 20.7% of the total tax liabilities (after credits) paid by individual taxpayers. In 1981 this percentage had grown to 58.7%, for an increase of 184%. By contrast, households with income in excess of $100,000 paid 6.7% of the liabilities in 1970 and 15% in 1981, for a percentage increase of 124%; households with income less than $25,000 paid 72.5% of the total in 1970 and 26.4% in 1981 for a decrease of 64%. This shift is magnified by comparing the 1960 percentages: for incomes less than $25,000, 79.7% of the total (decrease to 1981 is 67%); for incomes greater than $25,000, but less than $100,000, 14.9% of the total (increase to 1981 is 294%); and for incomes in excess of $100,000, 5.3% (increase to 1981 is 183%). See J. Pechman, supra note 12, at 358. For information concerning the use of tax benefits by income class, see Chapoton, Letter From Assistant Treasury Secretary John E. Chapoton To Joint Economic Committee Chairman Henry Reuss (D. Wis.), setting out revenue loss for tax expenditures distributed by income class, (Sept. 28, 1982) in DAILY TAX REPORT at J-1 (Oct. 18, 1982). The analysis by the Office of Tax Analysis suggests that tax benefits are most
group are understandably upset with this shift, and some have reac-
ted by non-compliance with the law.

The existence of tax evasion is not of itself surprising, but the
extent to which it has apparently spread is alarming. Estimates by
the Internal Revenue Service, which it suggests are probably low, in-
dicate that a significant amount of revenue is lost each year through
tax evasion. In fact, one of the justifications for the withholding
provisions of the Tax Equity and Fiscal Responsibility Act of 1982 was that such rules would enhance the compliance between the tax
law as configured and the level of compliance which exists, thus
making it easier to minimize future revenue deficits. The magnitude
of this level of noncompliance indicates a significant lack of faith by taxpayers in the tax system itself. The lack of faith is dis-

43. The IRS estimated that there was $100-135 billion of income not reported in
1976, with a corresponding loss in tax revenues of $19-26 billion. See INTER
REVENUE SERVICE, ESTIMATES OF INCOME UNREPORTED ON INDIVIDUAL INCOME TAX RE-
TURNS at 6, 11, & 17 (1979). However, in 1982, it estimated that the revenue loss
(implying tax dollars lost) to the government was $95 billion in 1981. See Hearings
Before the Subcommittee on Oversight of the Internal Revenue Code, Comm. on Fi-
nance, 97th Cong. 2d Session 95 (March 22, 1982) (Statement of Roscoe L. Eggers, Jr.).
The IRS changed its definition of the “tax gap” and its estimation processes from
1979 to 1982, but it is not clear to what extent. However, the statement of Commissioner
Eggers discusses tax revenue effects in a magnitude approximating the unreported rev-
enue from 1976, implying either that the IRS made changes in estimating which make
comparability difficult or a significant increase in noncompliance. Id. While the IRS
stated that it had refined its estimation process, the key to Coates’ statement is the
concern of the IRS with the trend in non-compliance, as evidenced by a tripling of
their estimated “tax gap” for the period 1973-1981. Id.

44. TEFRA added several provisions to the I.R.C. which were designed to close
the so-called “tax gap.” TEFRA, § 310, amended I.R.C. § 103 and 165 and added I.R.C.
§§ 165(j) and 4701, to require that all bonds be in registered form and to preclude the
use of bearer bonds. TEFRA, § 311, amended I.R.C. § 6945, to require brokers to re-
port to the IRS the gross proceeds of transactions entered into by their customers.
TEFRA, § 312, amended I.R.C. § 6778 and added I.R.C. § 6041A, to require more string-
ent reporting to the IRS by parties who pay independent contractors. TEFRA, § 313,
added I.R.C. § 6050E, which requires state and local governments to file information
returns with the IRS showing the amount of tax refunds paid by that government to
taxpayers. TEFRA, § 317, added I.R.C. § 3402(s), which requires additional withholding
of certain payments for a taxpayer’s failure to provide payors with correct taxpayer
identification numbers. TEFRA, § 314, added I.R.C. § 6053(c) and amended I.R.C.
§ 6678(3), to require information about tips to employees be furnished to the IRS by
employers in certain food and beverage establishments. TEFRA, § 301, added I.R.C.
§§ 3451-3456, which require withholding of taxes at the source for income from divi-
dends and interest.

The interest withholding rules were repealed by The Interest and Dividend Tax
amended in scattered sections of 26 U.S.C.). The Deficit Reduction Act of 1984, §§ 141-
63, made some additional changes to the compliance and reporting area.

45. See Senate Report, supra note 12, at 979.
turbining because it would indicate a trend which, if not reversed, could have very drastic consequences for the system as a whole.

While Congress has not acknowledged its role, it must bear a significant share of the responsibility for the recent increase in the rate of tax non-compliance. Congress is responsible for the legislation which becomes tax policy. As discussed earlier other tax actors have only advisory roles in policy formation. The Code, for many reasons—political exigencies, confusion as to goals, lack of central direction, to name a few—is complex and in some instances inequitable. Taxpayers are understandably unhappy with complex, inequitable laws. Taxpayers can show this dissatisfaction in many ways, but the two primary ones are by trying to force changes from within the system or by choosing not to comply with the requirements of the system. The recent growth in non-compliance strongly suggests that taxpayers are choosing in increasing numbers to disregard the system.

SUGGESTED SOLUTIONS FOR INCREASING COMPLIANCE

It appears that the present level of noncompliance is directly related to the level of complexity and unfairness in the Code. In tax terminology, the dissatisfaction appears to be with the tax base, not the rate system. Indeed, many tax analysts apparently still feel that a progressive rate system is fair.\(^46\) However, the method for determining taxable income—the tax base—receives much criticism.\(^47\)

In order to restore taxpayer confidence in the tax system, the following two-phased approach is suggested. While either phase could be implemented independently, it seems that using both would more completely answer taxpayers' apparent complaints. The first phase involves an analysis of current tax law to determine areas which do not appear to satisfy the goals of the tax system. The methods for developing the criteria necessary to measure what these goals are and whether they are being met will be developed further. The second phase requires a continuing reappraisal of the tax system, concentrating both on current configurations and prospective changes. The measurement criteria used in the present analysis phase could be extended to the ongoing reappraisal and future provision phase.

\(^46\) See note 16 supra. See also W. Blum & H. Kalven, The Uneasy Case for Progressive Taxation (1953); M. McIntyre, F. Sander & D. Westfall, Readings in Federal Taxation 75 (2d ed. 1983); Bihker, Tax Reform and Tax Simplification, 29 U. Miami L. Rev. 1, 4 (1974); and W. Blum, Revisiting the Uneasy Case for Progres-
vive Taxation, 60 Taxes 16 (1982).

\(^47\) See note 9 supra.
PHASE 1—CODE CONVENTION

In order to implement phase one, it is suggested that Congress call a Code Convention. Congress, rather than the President, should call the convention\(^4\) because recommendations could be implemented more expeditiously if the entire process was sponsored by the Congress. Congress also has several extant committees which could sponsor the convention.\(^9\) The convention process would entail a complete analysis of the current Code and its interpretations to determine areas of inconsistency, inequity, unfairness, or inefficiency. It should be composed of a panel of active and/or retired tax practitioners, tax academicians (accountants, economists, and attorneys), government representatives (elected and appointed), and, most importantly, taxpayers who are not in any way tax experts. Its recommendations would not be binding, but given the political nature of how members of Congress retain their jobs, the results of the convention probably would be given considerable attention in the House and the Senate.

The panel could be convened in Washington, D.C., for a period of several weeks to initiate the process. At this time the panel could be segmented into committees and subcommittees which would be assigned certain areas of the Code. In addition to committees assigned the responsibility of analyzing specific Code sections, it would be advisable to establish an overview committee charged with the responsibility of analyzing inconsistencies, discrepancies, and other situations where there are overlaps of coverage within the Code. The Treasury Department and the staffs of the standing congressional legislative committees would be available to answer specific questions. Once the initial phase has been completed, the individual members could disperse to continue their study and analysis. They would be periodically recalled for summary, sessions. This process could be repeated over whatever time period is necessary to complete the convention’s purpose.

The panel should be charged with the responsibility of analyzing tax law to determine whether the individual parts and the totality meet the goals sought to be accomplished by the tax system. Implicit in this charge is the ability to define what those goals are. Since one

\(^4\) For arguments pro and con on a presidential as opposed to congressional Commission/Convention, compare Walker, An Opportunity for Fiscal Reform, 1 FISCAL POLICY FORUM 2 (Tax Foundation Incorporated, Summer, 1983) with Martin, Taxation by Representative Government, 1 FISCAL POLICY FORUM 3 (Tax Foundation Incorporated, Summer 1983).

\(^9\) Any one of, or any combination of, the House Ways and Means Committee, the Senate Finance Committee, and the Joint Committee on Taxation would be appropriate to foster a Code Convention.
purpose of the convention would be to alleviate mistrust and anxiety by taxpayers, it would be helpful if scientific techniques were used to elicit what the majority of the populace thinks these goals should be. For example, consideration should be given as to whether tax law should be used to promote social justice, provide economic incentives, and so on.

A second prerequisite is that criteria be selected to determine whether the goals are being attained. Those criteria postulated by Adam Smith are as applicable today as they were two hundred years ago, and so the equity, fairness, efficiency, and burden of particular provisions should be evaluated. However, these criteria themselves are not useful as measurement devices. They are too abstract to have value as tools of analysis. Measurement devices must be stated in quantifiable terms so that the present configuration of the tax system and any changes to it can be analyzed, compared, and contrasted with some specificity and meaningfulness. Decisions about whether something is equitable, efficient, or fair is a value judgment based on the facts available to the decision maker. These facts which lead to the judgment of "fairness" are the measurement devices.

When evaluating individual provisions, care must be taken not to lose sight of the totality, i.e., the entire system. Thus the evaluation criteria also must be applied to interrelated segments and groups of provisions and even to the entire system on a cumulative basis to determine its ability to satisfy the consensual goals.

There are several advantages of a Code Convention. One advantage of using this approach would be that many participants would be experts who have dealt professionally with the present law. They would be able to expeditiously analyze the Code for inconsistencies and inefficiencies. Another advantage would be that any changes would be modifications of the existing system. Thus the end product would be one which was familiar to the public and practitioners and not threatening because of its newness. The third advantage would

50. See generally K. Arrow, Social Choice and Individual Values (2d ed. 1963). See also E. Stokey and R. Zeckhauser, supra note 7, at 257-90. One particularly useful technique involves a series of interactions, i.e., a feedback loop. Individual members of a group are polled on an issue and the results of this poll are disseminated to the group. The group is then re-pollled. This is repeated several times until a commonly accepted level of consensus is achieved. See Rusfeld and Foster, The Delphi Technique: Survey and Comment, 14 BUS. HORIZONS 63 (June 1971); Skutcher & Schofer, Goals-Delphis for Urban Planning: Concepts in Their Design, 7 SOC-ECON. PLAN. SCI. 305 (1973).

51. See note 11 supra.

52. One possible set of measurement devices would be social indicators. For a discussion of these tools see note 66 and accompanying text infra. See also note 16 supra, for sources which discuss the traditional economics and public finance techniques for analyzing these criteria of a tax system.
be the practicality of the approach; the participants would be investigating specific areas about known provisions.

However, there are some disadvantages to a Code Convention. Unless the convention was granted legislative power, any recommendations it made would have to be considered again by Congress before they could be implemented. Without congressional action, any positive changes suggested would not be fruitful. A second disadvantage of a Code Convention is that it likely would be a very costly and time-consuming process. Millions of dollars and perhaps as long as three years might be required for a complete analysis of the Code to determine the inequities and inconsistencies. At the end of this process, it would be necessary for Congress to pass legislation to bring about changes, which in itself could take six to twelve months from initiation to implementation.

Perhaps the greatest difficulty with a Code Convention would be in defining the measurement process, i.e., areas of inequity, unfairness, inefficiency, and undue burden. This is a very difficult and almost moralistic process because the definition of "inequitable" to a great extent depends upon one's personal and political biases. It would be possible to conclude that certain broad areas are either clearly equitable or clearly inequitable. However, there would still be many areas where there would be much disagreement.

The process outlined above would concentrate on specific elements of the current income tax base. As part of this analysis, consideration should be given to changing either the tax base, the tax rate system, or both. The current flat tax proposals and the variations thereof, including a consumption based tax, are manifestations of dissatisfaction with the current progressive rate income based system.

When considering changes in the tax base or rate system, analysts must be concerned with overall system results, not just the impact of an isolated element on the integrated whole. Thus, even though the tools of analysis and the performance criteria are no different, the implementation is much more complicated due to the inherent contextual interaction of elements within a system and the system's interaction with the entire social structure. Since this is the case, the results of any studies of system changes will be less accurate than those of element changes; therefore, decision makers should react accordingly. Should system changes be made, a monitoring pro-

cess should be established, similar to a sunset law, which would require periodic evaluation of the new system.

Changing the entire system offers several advantages. Such a significant break with the past could engender confidence in the system because it evidences a willingness by Congress to respond to apparent desires of the electorate. Changing to a broader tax base would eliminate many of the alleged inequities in the current tax base. The changes wrought would be extensive, systematic, and sweeping, not piecemeal and limited. Analysis of the rate system would either corroborate an apparent consensus for progressivity or underscore the need for a different rate structure. The entire system would be changed, not just elements of the system.

There are some significant disadvantages, however. It must be remembered that the power to tax would still be with Congress and Congress acts in a political system. Thus, it would be very likely that within a short period of time following the enactment of legislation changing either the base or rate system, special interest groups would press Congress for changes which would benefit their particular interests. If Congress bowed to the pressure and allowed exceptional treatment, it would be very difficult for it to resist the pressure to approve subsequent additional exceptions. Thus, the tax base again would be narrowed, creating anew the situation which currently exists.

Many exceptions and exclusions in the current tax base have long been a part of the system and people's expectations. Single family home ownership has grown significantly partly because of the tax deduction for mortgage interest expense. State and local financing is predicated on preferential income tax treatment of interest received from the states and municipalities. Charitable organization

54. Id.
55. Since its enactment in 1954, the IRC has been amended 17 times by "major" tax legislation, almost annually since 1971. See J. Pechman, supra note 12, at 40.
rely on the largesse of a population which is partly motivated by the fact that contributions generate tax benefits. Changing such ingrained expectations, for motives however laudatory, could result in significant social restructuring.

A broad based proportional income tax seeks to impose egalitarian tax treatment on society. It would by definition contain no preferences. Yet preferential treatment has been, and arguably should continue to be, a part of the tax system. Congress has sought to reach goals other than revenue raising by using the income tax system. A broad based tax would require new approaches to regulating the economy, encouraging and discouraging certain behavior, and achieving social justice. It is difficult to expect that a Congress long steeped in the use of the tax system to achieve these goals in the past could resist the temptation to do so in the future.

**Phase II—Reappraisal**

The second phase of the suggested approach involves using some mechanism to reappraise continuously the tax system to ensure that goals are being satisfied in the most acceptable manner. To be most effective, this mechanism should be a formal process which is sanctioned by the Congress. It must be comprehensive enough to consider the revenue and equity effects of current and proposed tax measures without being so massive that its usefulness is impaired. It must be able to consider these effects in the context of all the various elements and actors in the system and to determine their relative positions before and after implementing the changes. To be truly helpful, it must be simple yet provide meaningful information. To be efficient, it should use as much of the current system as possible.

As discussed earlier, Congress makes policy decisions when it passes legislation. This process of decision making involves two levels—the identification of alternatives and the decision to choose an alternative. These two levels should be performed by an analyst who

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59. The tax base is the statutorily defined subject of taxation, while the rate system is the amount of tax extracted for various levels of tax base. In a broad based tax, whether it be income, consumption, or some other basis, the definition of the base is comprehensive and provides for very few, if any, exceptions. A proportional tax would tax each level of tax base at the same percentage. For additional discussion concerning some of the proposed changes in the federal income tax base and rate systems, see note 9 supra.
is theoretically unencumbered by the need to decide and can thus give free rein to identification and evaluation of alternatives. Given the decision criteria used by the decision maker, the analyst can also rank alternatives in a preferential manner. The decision maker chooses from the alternatives presented by the analyst and does so based on a perception of the goals of the system. The decision maker is accountable for the results of his decisions, whereas the analyst is responsible only for performing tasks in an efficient, professional manner. The important point to note is that the reappraisal process is in reality a decision making process—the decision whether to continue, modify, or repeal the status quo. Thus, there is a need to consider how public policy decisions are made.

There is an increasingly expanding, interdisciplinary body of knowledge called decision sciences which offers some mechanisms for accomplishing these two decision phases. Many of the applications of the techniques have been in the physical and social sciences, business, and public policy, and thus the techniques could be used for the tax system.

A detailed discussion of all these methods is beyond the scope of this article. However, their application to the tax system would appear to be a fruitful area for future research. What we can do at this stage is describe a monitoring approach which will not of itself help identify alternatives but which will assist the analyst in providing better information about alternatives to the decision maker. The approach also will help the decision maker recognize the interrelatedness of elements of the tax system. We will call this method the holistic approach.

THE HOLISTIC APPROACH

The term "holistic" has been used in recent years to describe social welfare research in which the analytical model is system-oriented as opposed to element-oriented. The justification for the system approach is based on the premise that society is a complex, interactive system and that fruitful analysis must recognize this and deal with systematic as well as individual elements. As discussed earlier, elected officials make social welfare choices when they set policy. Thus, using a holistic reference point for policy analysis would appear to be a logical approach.

The holistic approach involves several stages. First the goals or...
desired ends of the system being analyzed must be ascertained. Second, the various elements which comprise the system must be identified. Next, the interrelationship of these areas or actors must be determined. Finally, a monitoring process must be developed to ensure that as changes are made to the system, the effect of those changes can be measured and evaluated.

As discussed earlier, several techniques have been developed to ascertain the goals of a large group or system. All involve some sort of consensus-building mechanism. To apply these consensus techniques to the tax system, either the electorate or its representatives would be polled. Trying to achieve consensus within the entire electorate would be a difficult task; it would be necessary to use statistical samples of the population, instead of the entire electorate, for the polling process. However, achieving a consensus of elected representatives instead of the electorate might raise doubts about whether the conclusions reached were truly representative of the wishes of the electorate. Setting aside pragmatic difficulties, the major problem with this approach appears to be the "group think" problem—i.e., whether the people polled are responding from their desires as to the goals for the system or whether they are transcending their desires and trying to anticipate the consensus.

For the sake of argument, it appears that the current goals of the tax system are generally revenue raising, resource allocation, economic regulation, and social welfare. Specific provisions of the Code have specific goals which would fall within one or more of these general areas. In dealing with those particular provisions, the goals would have to be redefined for the analysis to be valid.

Identification of the elements or actors in the system involves study and analysis of the system itself. The analyst must be able to abstract from the system those primary and secondary elements which cause the system to operate as it does. There is no shorthand technique for identifying these actors; the analyst must be familiar enough with the system to classify the system into its operative elements.

The next step in the holistic approach involves determining the interrelationship of the various actors. Again, this means that the analyst must be very familiar with the system itself. The emerging technique which has been developed to expedite this phase is the cross-impact matrix. This tool involves a listing of all the elements or actors involved in the system on both a horizontal and a vertical

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63. See note 50 supra.
axis. The matrix is then completed by indicating what the impact of each element or actor on the vertical axis is on each element or actor on the horizontal axis. The analyst develops some system of shorthand symbols to indicate this impact, and the symbol is included in the box which is the intersection of the vertical and horizontal elements. Table I is an example of a cross impact matrix, without symbols for impacts, for the tax system as a whole.

Two comments about the matrix itself should be noted before continuing our discussion of the process. In a system as broad as the income tax, many elements which are micro in effect must be considered when dealing with a specific proposal. However, for the purposes of this paper, it does not seem feasible to identify each of those micro-elements. For example, if the income tax deduction for interest paid for home mortgages was the proposal being analyzed, then the list of actors would of necessity include homeowners, renters, landlords, savings and thrift institutions, commercial banks, and other actors which might have an impact on the home ownership decision. For each specific proposal or element of the income tax, a similar list of actors could be generated. In addition, a detailed list of Code sections impacted would also have to be developed for each proposal. It is thus necessary to approach the income tax in a more fragmented manner than is normally done in using the holistic approach. However, for each such micro-decision, a micro-matrix could be prepared, and all such matrices could be integrated into a unified tool of analysis. Given the obvious complexity of such a task, it would be essential to adopt the matrix for computer analysis.

A final comment about the matrix before continuing the discussion is in order. The impact of interrelationships, discussed in a moment, has not been included because a specific proposal to be analyzed has not been posited. By identifying the actors and the specific goals of the system, a start is made in applying the holistic approach to the system. But at this stage, the analysis is abstract. Thus, it is not constructive to make sweeping generalizations about relationships unless dealing with a specific proposal.

Returning to the discussion of impacts, there are two levels which the analyst should consider. The first is his perception of the relationship between the two elements—that is, the impact of element 1 on element 2. This relationship can be expressed as varying magnitudes of positive, negative, or neutral signals. For example, in

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65. For an application based on Hayden, Boolean Digraph, supra note 64, see Warkentin and Menter, An Apple II Computer Program for the Social Fabric Matrix and Boolean Digraphs, 16 J. ECON. ISSUES 1027 (1982).
the home mortgage interest situation, the analyst might posit the impact of the deduction on thrift and savings institutions as positive. This initial estimate of the impact is based on the analyst's interpretation of the available empirical evidence, or if no such evidence exists, on the analyst's beliefs. Obviously the lack of empirical evidence weakens the reliability of the analysis.

A second level of impact involves the use of social indicators to monitor the interrelationship between the actors or elements. A social indicator is a social statistic which has some informative value because it has been demonstrated empirically that it is connected to some concept about a social process. Since the income tax system is, at least in a macro sense, a social system, social indicators could be developed for the system.

Some examples will help to illustrate the social indicator concept. Certainly the cost of collection, an efficiency criterion, would be a valid social indicator. This would in turn necessitate a policy choice as to the amount of resources to be applied to the cost of collection. The amount of revenue raised would be another indicator. Fraud convictions and fraud penalties assessed by the Internal Revenue Service would indicate the degree of voluntary compliance by taxpayers with the tax system. The growth in savings, the growth in capital investment both in general and in specific areas, and the growth in real terms in the economy would be indicators of the ability of the tax to stimulate or depress the economy. Finally, the development of statistics with regard to the people at the poverty level who, after transfer payments generated by the income tax system, such as the low income allowance, would be reclassified as above the poverty level, would be an indication of the ability of the income tax to shift income effectively. The above are more general indicators. New and specific indicators would be suggested by the specific proposal to be analyzed.

Social indicators are most helpful in measuring changes in relationships between elements and thus in monitoring the system. Once something has been posited as a social indicator, its present level can be measured. This measurement becomes a base against which future changes in the indicator are compared. The comparison tells the analyst what the effect of the change is.

To return to the home interest example, let us suppose the number of new housing starts is a social indicator of the relationship

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between the interest deduction and the housing industry. Suppose further that the current level is 1.5 million annually and that Congress is contemplating a partial disallowance of the interest deduction. The analyst speculates, after isolating and eliminating the effect of all other factors bearing on the housing industry, that the change will decrease the number of housing starts by .2 million the first year and .1 million every year thereafter. At this stage, then, the projection is a negative impact on the actor housing industry by a change in the element interest deduction. Having determined this negative impact, the analyst will return to the matrix and change the sign in the impact portion of the matrix cell to correspond to the new perception. If a negative impact is acceptable to Congress, the decision maker, based on its perception of goals, i.e., balancing revenue gains against disincentives, the measure would be enacted. Now suppose a year later the analyst discovers that new housing starts have dropped .5 million. After isolating other reasons for a drop off, he concludes that the disallowance in reality caused a decline of .3 million units. If this is not acceptable to the decision maker, a partial restoration of the deduction would be called for since there is not a congruence of results with the goals sought.

There are obvious questions about whether decision makers would be any more inclined to make changes and admit prior failings under this system than under the current one. Setting aside this pragmatic concern, the proposed system would be appealing because it would institutionally incorporate both measurement and monitoring sub-systems. Thus it would be useful for making current decisions and for evaluating the efficacy of prior decisions.

By identifying the goals and the interrelationships of the actors and elements of the particular system, the holistic approach allows the analyst to rank alternatives based on their relative changes. Since it is a systems based approach, the analyst can be more confident that all possible outcomes have been identified.

The final question to be resolved with regard to the holistic method in the context of the income tax system is the identity of the analyst. Several likely candidates are the staffs of individual Representatives and Senators, the House Ways and Means Committee, the Senate Finance Committee, the office of the Assistant Secretary of the Treasury for Tax Policy, and individual taxpayer groups.

It would be too burdensome and grossly inefficient for each Representative and Senator to have on staff one or more individuals capable of effectively using the holistic approach. Experience is a key to the use of the technique, as is stability. Since there is significant
turnover in the staffs, as well as in the ranks of the elected officials, individual analysts of this nature would not be useful.

There is more stability on the staffs of the tax committees of the Congress, even though the composition of the committees' membership changes, as does the leadership. Thus a case could be made for holistic analysts to be permanent members of the staffs of the Ways and Means Committee and the Senate Finance Committee. These individuals could cooperate to some extent in structuring their analyses. As an alternative, the staff of the Joint Committee could contain the holists.

To ensure full analysis and to recognize the political realities of the nature of the relationship between the Executive and the Congress, the Office of Tax Analysis of the Assistant Secretary of the Treasury for Tax Policy should also contain holistic analysts. In this way the analysis developed by one branch could be compared to that developed by the other. Hopefully this would enable both Congress and the President to make better decisions. Once computer techniques were developed, the duplication would not be significant in light of the information generated.

Certain taxpayer groups could afford to employ holistic analysts, but since such groups are by nature limited issue or limited constituency groups, the analyst would be primarily using micro-matrices instead of full system analysis. However, if used in conjunction with the full system analysis by the Congress and the Treasury, the private analyst's work product could provide significant information on segments of the system.

Obviously there are disadvantages to the use of holistic analysis. The approach has not been applied to a social system on a national level. Thus there would be a significant start up cost from applying it. It is very difficult to use because of the decisions which must be made as to the interrelationships among the various elements involved. It is also difficult to project what the effect of particular legislation would be on those interrelationships with any degree of specificity. There could also be disagreement among policymakers with regard to the magnitude of an effect on particular elements of the system.

One may question whether the holistic approach is a significant improvement on current techniques used by the tax system policy makers to make choices for alternatives. Perhaps in regard to particular elements there would not be a significant difference. However, in attempting to and actually identifying actors and elements and their interrelationships for a full system, it seems that there is much benefit. Just the recognition by policy implementers of the large
number of actors and elements involved in the tax system will make for better decisions.

CONCLUSION

Considerable dissatisfaction exists with the current federal income tax system. One reason for this is the disenchantment felt by the middle class taxpayer. There is considerable concern that the system as presently configured does not provide for sufficient equity or fairness for all taxpayers. This lack of faith has apparently resulted in an increase in noncompliance with the tax laws.

Broadening the tax base or flattening tax rates appears to be an appealing solution. But these changes would be fairly radical and, given the current impact of special interest groups, could well be temporary in effectiveness. Once sufficient political pressure is exerted on Congress to enact exceptions, the tax system would become again the patchwork quilt it presently resembles. Only if the power of interest groups is somewhat diminished would radical changes be effective.

The Code Convention alternative offers much promise because it involves gradual changes in the current system. It would make use of the expertise and research which has been generated over the past seventy years. In conjunction with a convention, the holistic approach for monitoring the tax system should be considered. The convention would deal with current problems and the holistic approach with preventing future ones. Both would build upon current knowledge, and changes would be evolutionary, not revolutionary.

Whether Congress chooses one or more of the alternatives analyzed above or some other course of action not discussed in this article, it is clear that now is a critical time for our tax system. The key to the system has always been the voluntary compliance with the law by those subject to it. Their faith is being sorely tested. Congress must act to restore that faith.

67. One significant reason that interest groups exert such power is due to the campaign financing laws and the growth of political action committees. Until there is a change in these laws, the power of the interest groups will not diminish, and thus it will be difficult to pass and maintain a broader based income tax system. See, e.g., Dodd and Schott, supra note 40, at 202-07; B. GINSBERG, THE CONSEQUENCES OF CONSENT: ELECTIONS, CITIZEN CONTROL AND POPULAR ACQUIESCENCE (1982) 220-28. See generally MONEY AND POLITICS IN THE UNITED STATES: FINANCING ELECTIONS IN THE 1980's (M. Malbin 1984).
## Table I

### General Cross Impact Matrix for Federal Income Tax System

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