Tax Lawyers and Tax Policy

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On several recent occasions, economists and political scientists have raised this question: Why do lawyers who are knowledgeable about the federal income tax react negatively to the suggestion that substantial rate reduction be coupled with elimination of the major preferential provisions in the law? It has been apparent for some time that, without affecting the over-all yield of the individual income tax, the rates could be compressed under a ceiling of fifty per cent if the tax base were tightened up by treating capital gains as ordinary income, stopping the escape of gains through gift or transfer at death, taxing interest from state and municipal bonds, reducing percentage depletion rates to levels compatible with cost depletion, paring down excluded fringe benefits, and halting deduction of some items not connected with seeking gain. Indeed, a rigorous closing of the escape paths would make possible an even more drastic rate reduction without disturbing aggregate revenues from the tax. Considerable enthusiasm for a program along these lines has been generated among economists familiar with fiscal affairs. But with the exception of a few academic members and a stray here and there, all efforts to launch such a program seem to have been ignored or accorded an icy reception by the tax bar. Virtually no toehold has been gained even though the move on the whole would definitely benefit lawyers in their roles as taxpayers inasmuch as their professional earnings by and large do not qualify for any of the specially favored treatments. The question of why lawyers act against what appears to be their own self-interest surely deserves to be considered.

Of course I do not presume to speak for the tax bar or even a part of it; neither can I furnish a reasonably full answer to the question. At best, I can only pass along some incomplete observations, growing out of numerous contacts and conversations with lawyers active in the tax field which suggest why they are hostile to the proposal. And I report these as inconclusive and unverified reflections in the hope that others will challenge or correct or supplement the explanation which emerges.

To begin with, the typical tax lawyer appears not to take the proposal seriously because he is sure that it is a political impossibility. A plan to abolish all the principal preferences would encounter the combined opposition of many vocal and powerful groups, and is unlikely to incite the unorganized taxpayers who would benefit from rate reduction to march on Washington. Treating the proposal as visionary, the tax lawyer need not, and frequently does not, examine carefully his own thoughts on the merits. Often it is unclear whether his remarks on the subject are facetious or in earnest. Perhaps the most telling clue here is the abundance of jibes and Witticisms. But whatever these are intended to signify they surely contribute much to spreading the impression that the bar is dead set against the suggestion.

As might be anticipated, the most outspoken and articulate critics seem to be closely associated with taxpayers who have a heavy financial stake in maintaining the status quo. We should expect that tax counsel employed by business firms are often unable or unwilling to be more impartial in judgments on tax policy than their employers, at least when not surrounded by complete privacy. To a lesser extent this handicap applies to independent counsel who regularly represent certain well defined financial interests. And no doubt it operates for the wealthy lawyer who in effect has himself as a client. At some stage of his career he well might be more concerned with taxes on his accumulation of wealth than on his current or future professional earnings.

But virtually all tax lawyers perceive that the proposal would render obsolete much of their specialized knowledge and art. We should not underestimate the amount of specialized learning which has been accumulated by the expert in taxation, and we must recognize that it is only human to protect one's investments from destruction. While there would be a demand for his services even after the system was stripped of its preferential aspects—since transactions would still carry tax consequences—the market for the expert's talents would be markedly altered if taxes were simpler and rates lower. Once the existing stock of knowledge became obsolete, newcomers could more easily establish themselves. And once the system were more neutral, the need for elaborate planning to minimize taxes might be reduced. In these respects, the position of today's expert would deteriorate and his earnings might be expected to fall. Before that time arrived, however, the multitude of problems emerging from the transition to the new law would certainly keep his business output at high levels, quite likely for years and years.

The prospect of such a transition gives the tax lawyer still another reason to recoil from the proposal. Any lawyer is inclined to be defensive about arrangements he has worked out for his clients and to guard against changes which are disruptive. There is an understandable feeling that if things fail to materialize as planned, even if solely because of new legislation, somehow the planner will be considered to have fallen below the mark in serving his clients. In contrast, there is commendable pleasure in Seeing one's advice and suggestions achieve their stated goals. No craftsman enjoys watching his own handiwork come tumbling down.

Pride apart, the tax lawyer is apt to be acutely aware that problems of transition usually are more numerous and dogged than the proponent of change cares to admit. A myriad of business, estate and personal plans have
been built on the present rules of the game. Even if there is no warrant in law to assume that they will continue indefinitely, the fact is that as a practical matter it would be unwise, as to most of the preferential provisions, to assume anything else. Repudiation of the preferences inescapably would require a massive unscrambling of old plans and formulation of new models. In the process, there are bound to be heavy casualties. Some lawyers would be unable to reorient their thinking; some taxpayers would be trapped into undesirable tax positions; in the rush some taxpayers would not get competent advice; and inevitably there would be windfalls and unintended penalties. All this is to say that the usual costs of changing a tax law undoubtedly would be magnified greatly under the neutrality proposal—and the tax lawyer is likely to be most sensitive to the import and extent of these costs.

Of greater significance, probably, is the fact that the tax lawyer typically does not regard the preferential provisions as lacking justification. It is a good guess that the average tax specialist thinks that most of these gaps in the tax base deserve to be preserved on what he regards as their merits. In not a few situations, however, it seems that his appraisal is colored by a one-sided vista of the preferences in operation. Take the treatment of capital gains as an example. When one has operated closely and repeatedly with the legal distinction between capital gains and ordinary income, the two concepts tend to be viewed as having a difference in reality which calls for a different treatment in law. The lawyer, moreover, sees the capital gains provisions operate in the context of the actual affairs of particular clients; and he therefore is likely to reflect on how the tax burden would have been repressive in the absence of the special dispensation, noting what plans the client might not have been able to carry out if the gain attracted the full weight of tax. From such musings, he might readily conclude that the dispensation is meritorious in that it promotes activities or arrangements which are desirable or important not only for his client but perhaps for society as well.

This point might have a considerable reach. The main case for eliminating preferences is that taxpayers in comparable economic circumstances should be treated alike, and the force of this position can be appreciated only when taxpayers are viewed at a distance and compared in the large. Where the situation of one taxpayer or one class of taxpayers is studied narrowly at a close range, it usually is not difficult to locate grounds for granting special tax relief to that individual or group. Such an approach is merely another version of the old story of justifying the protection of particular industries with tariffs without considering the economy and all its constituent parts in panoramic fashion. Many tax lawyers seem especially susceptible to this weakness because they repeatedly are engaged in dealing narrowly with the aspirations and fears of particular clients. And the vulnerability of the tax bar in this respect increases as its members become more specialized, concerning themselves with an ever smaller range of tax problems.

Their compartmentalized view of the tax system also tends to produce another common reaction in tax lawyers. One preference is readily justified by the existence of others. Today if a certain preferential provision is called into question, the lawyer's response frequently is that it is not significantly different from other special dispensations, and that it operates to equalize tax burdens. A fully neutral tax system of course would destroy the basis for this line of reasoning. But lawyers do not always distinguish the usual challenge to a specific preference from the more novel challenge to the whole range of preferences; and even after the two issues are differentiated, some find it hard to overtake their quick reaction to the more familiar question.

Another facet of the experience of tax lawyers which affects their attitude towards the neutrality program arises out of their contacts with the tax administrators. It is no secret that tax consultants frequently believe that government representatives are arbitrary, unreasonable, and even worse. Operating on this appraisal, the lawyer in practice might welcome a highly complex and uneven law which generates more issues and thereby affords him additional opportunities to bargain and maneuver in his contests with the administrators. Some practitioners are so sensitive about administrative harassment and abuse that they brush aside the consideration that a more neutral tax system would curtail the discretion of administrators by reducing the number of arbitrary distinctions rooted in the law. Maybe this is irrational; but reactions to governmental arbitrariness often carry men to great lengths and indefensible positions.

There is another strong source of the tax expert's wariness about the program. By training and experience, the lawyer has conditioned himself to look ahead and vis-
ualize consequences and conditions which would not occur to the uninitiated, and the tax lawyer is regularly challenged to call this faculty into play. When it is applied to the neutrality proposal he immediately detects a trap: Granting that somehow rate reduction can be traded for loophole closing now, is there any assurance that the “bargain” will be maintained in the future? It goes without saying that the present Congress cannot bind its successors and that the deal hardly could be given constitutional status. With the tide running in the direction of larger doses of the welfare state, and with potential national emergencies lurking all over the place, surely there is cause to speculate that someday if more tax revenue is demanded the government will repudiate the old agreement. At such a time, it might be simple to raise rates without restoring the old loopholes, especially in the face of the arguments which earlier had been advanced in public for getting rid of them. And who knows whether new escape routes could be developed before it was too late?

Clearly in the background of such thoughts there lies a distrust of popular government. In stating the proposition so baldly, no reproach to the profession is intended. Merely because he represents persons of wealth, and bends his efforts to conserve that wealth, the tax lawyer ought not be suspect when he exhibits concern over a too-generous use of the taxing power. More than others he is in a good position to observe the disastrous consequences of very high taxes in particular instances. As these occasions grow in number, it would not be surprising for him to reach the conclusion that very high surtaxes are incompatible with the type of society he favors. And from there, it is only a short step to the view that, as a person especially knowledgeable about taxes, he has a special commission to guard against erosion of that form of society through high taxes. At such a stage the neutrality bargain is apt to be classed as dangerous and unacceptable.

A better light can be placed on this attitude when it is stated in another way. The power to tax is the power to destroy—not only individuals and firms, but the vitality of a society which is founded in considerable part on private enterprise. It has yet to be demonstrated that maintenance of a free or open society is possible in the absence of numerous pools of private wealth, nourished out of the income stream. The uninformed electorate may not be able to appreciate the destructive capacity of high taxes. The tax lawyer often thinks he does.

Thus many a tax lawyer does not approve of using taxes to redistribute income—at least not on a large scale; and he looks upon the well established preferential provisions in the law as a brake against more radical redistribution. Two elements of possible braking power seem to be provided by the preferences. As long as there are large holes in the tax base, the revenue potential from higher surtax rates is reduced. It is conceivable that Congress might be reluctant to raise surtaxes knowing that the relatively small tax increase would be concentrated and piled on those who cannot take refuge in the preferred havens. A paradox perhaps is to be found here. While in the past the loopholes made higher rates palatable, the continuation of the loopholes might make further rate increases less digestible. The other braking element is more easily demonstrated. It has been pointed out that
the unevenness of the tax base, which is accompanied by a complicated superstructure of technical law, makes it difficult for Congress to act with proper dispatch in raising or lowering taxes. Every time it reconsiders revenue needs and tax rates, the legislators are practically compelled in effect to redate the equity and economic consequences of each of the major special dispensations. All this not only takes time but invites a great deal of technical rhetoric and flak which obviously tends to bog down passage of rate change legislation. When revenue increases are the order of the day, the tax lawyer can be thankful for the drag of the preferences. And when the occasion again (if ever) arises for revenue reduction, he can look upon it as an opportunity for extending old preferences and creating new ones.

For some reflective tax lawyers, there is more behind these attitudes than distrust of popular government and dislike of drastic economic redistribution. If the income tax were purged of its major preferential features, the “class” nature of progressive taxation would immediately protrude more prominently. Any legislative review or change of rates would tend sharply to divide forces in terms of income or wealth alone, and thus highlight tensions stemming from economic inequality in our society. To those who abhor such direct clashes, our network of preferential provisions might seem to be a blessing. The actual distribution of tax burden is not known to the public (and probably not even to the experts); and the nominally high surtax rates can pacify persons with low incomes while the preferences can comfort those at the upper end of the income scale. Especially in the legislative process, this ignorance, confusion, and irregularity might serve to reduce friction and keep passions in check. When the tax base is a patchwork, the rich do not always seem to be lined up against the poor, and surely the long technical arguments and discussions about details do dissipate large charges of energy which otherwise could be more troublesome. In this view, the advantage of the present structure is that it makes the graduated income tax less divisive—which is no small accomplishment.

It remains to be noted that these thoughts which I have attributed to some “typical” tax lawyers point to a condition found in most advanced western societies. There is a near deadlock in the field of income taxation. In almost each advanced tax system, there is the familiar combination of nominally high surtaxes and a sievelike tax base; and almost everywhere in the face of demands for larger tax revenues there appears to be little pressure or disposition to alter the combination. We have yet to understand what brought about and perpetuates this condition. I wish only to suggest that some of the considerations which seem to have influenced the attitudes of tax lawyers might possibly have contributed to its making.

Kenneth Craddock Sears, 1890–1961

The Law School notes with deep regret the death, in December, 1961, of Professor Emeritus Kenneth C. Sears.

Professor Sears received his Bachelor of Arts degree from the University of Missouri in 1913. An alumnus of the Law School, he received his J.D. in 1915. After serving briefly in the office of the Attorney General of Missouri, he practiced in Kansas City until 1919.

Professor Sears then joined the Faculty of the University of Missouri School of Law, where he taught until coming to the Law School in 1926; he became Professor Emeritus in 1956, and since that time had resided in Santa Barbara, California.

While Mr. Sears taught, among other subjects, Criminal Law, State and Local Government, Municipal Corporations and Evidence, he was best known for his work in Constitutional Law and Administrative Law. He was the author of a casebook on Administrative Law and co-author of the 4th edition of May on Crimes.

Professor Sears’ work on Methods of Reapportionment, published by the Law School in 1952, reflected his long-standing interest in the problems of legislative apportionment, and the efforts he expended over many years to bring about a reapportionment of the Illinois General Assembly. He made also a major contribution to state and local government as the principal draftsman of the Revised Cities and Villages Act (Illinois) in 1941.

The bare outline of his career as recited above fails entirely, of course, to reflect the esteem and affection in which Kenneth Sears was held by his colleagues and by a generation of students.