

I

Louis Eisenstein's book, The Ideologies of Taxation, is a devastating attack upon "the modes of thought to which groups and interests resort in order to obtain tax laws to their liking." It reprimands the use of phrases lacking meaningful content, arguments inconsistent with the facts, and sloppy thinking in general. The author demonstrates effectively that folklore and myths play a disturbingly dominant role in shaping tax policy. I daresay that virtually every reader who has ever discussed or considered tax-policy problems will find at least one of his own pet theories thoroughly "debunked." This, of course, is a rather unsettling experience—but for those not addicted to complacency, an extremely stimulating and worthwhile experience. This is so not only because there is an important lesson to be learned but also because, in this instance, the lesson is stated with brilliance of language and analysis and with an abundance of tongue-in-cheek wit.

The book begins on a note of cynical realism. The reader is reminded of the fairly obvious, but too frequently ignored fact that the tax system is the product of the political accommodation of pressures resulting primarily from self-interest. "Our taxes reflect a continuing struggle among contending interests for the privilege of paying the least." But one of the central themes of the book is that naked self-interest has not been regarded as an acceptable basis for demanding the adoption of a given tax provision or system. Instead reliance has been placed on arguments whose sole virtue is that they bestow upon their proponents an appearance of selflessness, neutrality, and dedication to the "public interest." Eisenstein divides such arguments into three categories, the three "ideologies" of taxation: ability to pay, barriers and deterrents, and equity.

The author first directs his attention to the ideology of ability to pay. He traces the origin of this concept, as used in the development of this country's tax system, to the arguments over the adoption of a progressive income tax. He expresses approval of the candor which characterized the early debate on this issue: the class discrimination which this form of taxation imposed was either deplored or praised, but it was not denied. Later the proponents of the tax became more "discreet" and began to rely on the ability concept. Thereafter they "firmly assume[d] that this concept provides a principle of taxation which is happily unmarred by selfish interest or bias." Their reasoning was that since increments to higher incomes were of less utility than increments to lower incomes, progressivity in the income tax was required in order to

1 P. 224.  
2 P. 3-4.  
3 P. 21.
achieve "equality," "justice," and "neutrality." But, Eisenstein observes, even if the somewhat questionable premise is conceded, the conclusion simply does not follow; whatever may be the justification for progressivity, it cannot be said that progressivity leads to "equality and neutrality" unless we "indulge in a strange use of English." At the same time he takes issue with the concern of Professors Blum and Kalven that the marginal utility of income to the recipient cannot be measured. In his view this is irrelevant; regardless of the psychic value to the recipient, a social evaluation can and should be made. To the Blum and Kalven rejoinder that society should not make this kind of evaluation, his response is simply that as long as we have taxes a choice between various kinds of tax must be made; any tax therefore reflects such a social evaluation. One need not take sides in this debate in order to appreciate the basic point that a progressive tax can be justified, if at all, only as a measure designed to mitigate disparities in wealth.

Eisenstein’s dissatisfaction with the ability to pay doctrine stems from the doctrine’s rejection of this point.

On a somewhat less academic level, Eisenstein points out that the ability ideology offers no answer to the question of how progressive the rates should be. This, of course, is the really important issue. He then proceeds to discuss certain current applications of the ideology and the significant departures from it. The departures are used to demonstrate the lack of utility of the doctrine; any departure must be assessed on the basis of social and economic policy considerations which have nothing to do with ability to pay. In short, he concludes, "to speak forcefully of ability to pay is merely to indulge in evasive rhetoric."

Eisenstein next considers the "gloomy" ideology of barriers and deterrents, which "dwells on the alarming theme that the economy is deteriorating because the rates are too high." The predominance of this theme in current tax-policy discussion results in a wealth of material which is peculiarly vulnerable to Eisenstein’s kind of attack. The first step in his technique is to devote considerable space to quoting and summarizing the positions taken by the adherents of the ideology; thus he forecloses any argument that he is attacking a "straw man." Next he simply states the facts. The ideology falls of its own weight, assisted, however, by the author’s subtle, biting, witty sarcasm. For example, he cites all the dire predictions, past and current, as to the wrack and ruin which can be expected to result from high individual rates. Among these are statements made by Secretary Mellon in the early twenties. He points out that “through the heroic efforts of Mellon the ideology of barriers and

4 P. 26.
5 BLUM & KALVEN, THE UNEASY CASE FOR PROGRESSIVE TAXATION 64 (1952).
6 It should be noted that a progressive tax is not essential for the purpose of raising revenue. Professor Smith amply demonstrates this point at page 17 of his book, Federal Tax Reform, which is reviewed herein.
7 P. 56.
8 P. 59.
deterrents enjoy a Golden Age of about seven years. Between 1925 and 1932 the highest rate of income tax was 25 per cent." He proceeds to describe in detail, in the language of the ideology, the advantages which the adherents assumed would follow from this situation. Thus the victim is fattened for the kill, which begins with the following statement:

Now if facts were relevant, the ideology of barriers and deterrents would soon disappear. Very low rates were followed by unparalleled disaster. Very high rates have been accompanied by unprecedented growth. . . . But since the facts are irrelevant, the ideologists of barriers and deterrents courageously carry on with the same words and phrases.10

Of course, Eisenstein is too good a lawyer to rest his case on this dramatic but somewhat inconclusive opening argument. He proceeds to discuss the mass of empirical data and experience which indicates that, in spite of the current high rates, executives are working as hard as ever. He then goes on to raise a "more subversive question":11 are we really committed to the notion that encouragement of non-business efforts, or even leisure, is an evil to be avoided at all costs?

Various other forms of the ideology of barriers and deterrents are attacked with equal vigor. Thus, in addition to the "dogma of declining effort,"12 he discusses the "dogma of diminishing risk"13 and the "dogma of inadequate savings."14 His attacks on these are clever, incisive, and well documented. It is true that the facts available do not rule out all possibility of adverse economic effects. But the facts are, when used by a writer of Eisenstein’s skill, sufficient to make the typically extreme positions taken by the barriers and deterrents ideologists look untenable if not ridiculous.

Are the proponents of lower individual rates left without any argument then? Not necessarily. Eisenstein suggests, somewhat fleetingly, that they "might argue that when a rate passes beyond a certain point, it becomes unethical and hence unworthy of enactment."15 This is presumably a counterpart to the suggestion to the ability ideologists that they candidly support progressivity on grounds of social policy. Eisenstein does not appear to hold any illusion that the suggestion will be adopted by either group; in this era an appearance of selflessness is thought to be absolutely essential.

After devoting separate chapters to capital gains and depletion, he discusses the third ideology in a chapter entitled "The Wondrous Ways of Equity." His general point is that the term "equity," together with its various synonyms, is, and for the sake of serving its purpose must be, essentially meaningless. "An ideology must speak in majestic tones, but it should shun any effort to be too instructive. Its power to persuade hinges largely on its failure to enlighten."16 The essential tenet of the ideology of equity, according to Eisenstein, is that equal incomes should be equally taxed. One difficulty

9 P. 65. 11 P. 74. 13 P. 77. 15 P. 66.
10 Ibid. 12 P. 75. 14 P. 79. 16 P. 149.
with this notion, he says, is that it fails to enlighten us on the really difficult issues, such as: should the recipients of equal amounts of capital gain, dividends, and salary be regarded as having equal incomes? As another example, the ideology does not tell us whether an income tax is more “equitable” than a sales tax.

Getting more specific, he cites instances in which “equity” has been used to justify individually tailored statutes. One of his leading examples is the statute enacted to tax at a rate of 25 per cent, rather than 91 per cent, compensation paid to Louis B. Mayer on retirement. Of course the “bunching” problem may be thought to have justified the provision. Eisenstein’s point is that special provisions can be justified if they are enacted in response to special circumstances but should not be enacted solely in response to the influence of a particular individual.

Of even greater significance, I think, is Eisenstein’s attack on what I would refer to as the “me too” psychology of the tax-policy thinking of our day. This appallingly prevalent attitude accounts for a substantial proportion of the “tax-relief” provisions which have been subject to widest criticism. The notion is that if one group of taxpayers is enjoying a given tax benefit, then other similarly situated groups should be equally entitled to it. A good example of Eisenstein’s skill as a writer is the following passage in which he describes and at the same time shatters this kind of selfish, narrow-minded thinking:

When a dispensation is desired in the name of equity, the request need not be justified on the basis of alleged merit. It is enough that the dispensation is already enjoyed by someone else who can be considered similarly situated. Nor is it material that the dispensation was originally granted for some unrelated purpose. Equity is not concerned with such details. The sole question is whether those who are aggrieved have the required resemblance.17

The final chapters of the book are devoted, at least nominally, to demonstrating the uselessness of the terms “loophole” and “public interest.” In the course of this demonstration the author is able to make some provocative miscellaneous observations. For example, he indicates his very pessimistic attitude toward the prospect of disinterested tax-reform leadership from the tax bar at large or the ABA Section on Taxation in particular. In addition, he takes issue with the notion that “special dispensations” (his supposedly neutral substitute for the term “loophole”) are a result of high rates and that the pressure for such dispensations will tend to disappear if the rates are lowered. To this he reacts with skepticism, stating that, while such “talk is very contagious,”18 the fact is that, for the group primarily interested in lower rates, any rate “will always be too high” because “in their considered view income taxes are inherently evil.”19 In any event, lowering the top rate to 65 per cent,
as some of the ability adherents are willing to do, certainly will not reduce the wealthy taxpayer's feeling of persecution and clamor "for relief." This is certainly an interesting speculation which appears to have at least as much foundation in experience as the position which it attacks. Unfortunately, we have little basis other than pure speculation for choosing between the two views.

II

The ideas presented in The Ideologies of Taxation offer an interesting and useful framework for analysis of Dan Throop Smith's Federal Tax Reform. But standing alone such an analysis would be somewhat unfair in light of the avowed purpose and scope of Smith's book. Federal Tax Reform does not purport to be thorough, scholarly, or rigorous; nor could it be without defeating its purpose. That purpose is to present to the general reader, in a palatable dish, virtually all the current issues of tax policy, as well as the author's suggestions for reforms which he regards as politically possible. The purpose is well served. Even the more difficult issues are presented in an interesting and comprehensible manner. The book is generally quite readable (considering its subject-matter), though there are passages which bear the signs, both in language and reasoning, of a rush job. Smith's discussion is far more informative and much less affected by bias than most statements on tax issues addressed to the general public. Moreover, most of his suggestions for reform are quite sensible and sound; they are suggestions on which there would be widespread agreement by objective experts. The author has performed a very worthwhile service in presenting to the public the arguments in favor of such a broad array of desirable proposals. This being so, it may seem a disservice to the cause of tax reform to take issue with the more controversial general premises on which he relies. But to the extent that these premises are used to justify questionable proposals they cannot be ignored.

Smith is a man of very strong opinions and biases. These are by no means concealed, but, coming from the pen of an expert, there is a distinct danger that they may be regarded by the non-expert as unchallengeable. This is especially so with respect to the more complex, technical, and difficult issues, such as the depreciation deduction. Nor is the reader given a fair presentation of both sides of the argument on many issues which are the subject of serious objective controversy. It is true that Smith is scrupulous to mention views inconsistent with his, but in most instances this merely amounts to paying lip service to impartiality. Thus, he may enter a note of caution as to the lack of theoretical agreement or empirical support for assertions as to the effect of a given tax upon economic activity. But the assuredness with which he finally makes such assertions seems to overwhelm the note of caution.

Smith's central theme is that upper-bracket individual tax rates are too high. In reaching this conclusion he purports to rely in large part on what
Eisenstein calls the ideology of barriers and deterrents. Thus, says Smith, the individual rates are too high because (among other reasons) they reduce economic incentive and thereby reduce individual effort. He does not question the proposition that any tax which discourages individual business effort is ipso facto pernicious. But assuming that one is willing to accept this proposition, major difficulties remain. Smith concedes that high tax rates may actually result in increased efforts by persons who wish to reach or maintain a standard of living which they regard as minimum. He also concedes the significance of non-pecuniary motives for business effort. Yet he concludes, without pretense of empirical support, that on the balance individual efforts will be decreased in a significant amount by the high rates. Those like myself who are not prepared to join with him in this "leap of faith" may tend to lose confidence in his judgment on other matters. This reaction is intensified by the manner in which his conclusion as to the relationship between taxes and individual effort is used throughout the book: he suggests that, because of the presumed relationship, not only must the upper bracket rates be lowered, but other reforms should be considered dependent upon or subordinate to the achievement of this objective.

At times, however, Smith justifies his opposition to high rates in more emotional terms. Thus, at one point he states that "our present virtually confiscatory individual tax rates" are largely the result of the New Deal's "punitive attitude toward wealth." This kind of existentialist approach to taxation may be honest and therapeutic, but it seems more likely to result in a hardening of adverse positions than in a meeting of the minds. Moreover, if the desired rate of progressivity is to be determined on this kind of "guts reaction" basis, then I should think that the chances for a reduction in the present high rates are rather remote. But perhaps Eisenstein is correct in his view that the issue cannot properly be argued in any other terms.

As indicated before, however, the central theme is the ideology of barriers and deterrents. Implicit in that ideology is the assumption that the principal goal of tax policy is the promotion of economic growth. For Smith, economic growth seems to be not just a goal but an obsession. At the same time, his approach is eclectic. He also relies on the goals of "fairness" (which, of course, is synonymous with "equity") and "simplicity" (which is equally unenlightening). For reasons similar to Eisenstein's, he regards ability to pay as "little more than a phrase." Instead, he leans toward the countervailing theory, which is taxation in accordance with benefit—a somewhat Draconian and now rather unfashionable viewpoint. For example, in discussing personal exemptions, he states:

Even if government services could be financed by taxes imposed solely on the rich, action to do so would be an unintended application of the supposedly repugnant slogan of "from each according to his ability; to

20 P. 35. 21 See pp. 423, 427 supra. 22 P. 13.
each according to his need." Any denial of universal responsibility for the support of government is untenable. . . . Essential government services are an integral part of everyone's standard of living. . . .

On specific issues, the availability of good concrete arguments usually makes it unnecessary to rely on controversial abstract theories. Thus, without regard to such theories, Smith is able to present forceful arguments for such proposals as denial of capital-gains treatment to lump-sum withdrawals from pension plans, taxation of interest on state and local bonds issued in the future, and gradual elimination of percentage depletion. As to other matters—such as the business expense account and the deduction of interest on home mortgages—he effectively presents the current problem and indicates the difficulty of achieving an entirely satisfactory solution; the solutions which he does suggest are reasonable and practical compromises, even though they do not go as far as others might like. At the same time, he does not hesitate to suggest drastic changes where they seem appropriate and politically feasible. For example, he sees no reason why mergers which are in effect equivalent to sales should not bring about the same tax consequences as sales. Accordingly, he suggests that "the definition of tax-free reorganizations could be tightened to limit it to exchanges involving recapitalizations of a single company or a single predecessor and a single successor corporation." To the tax specialist who might regard the suggestion as too drastic he points out that "the present broad definition is a surprise to nonexperts when they first learn of it as well as to tax specialists in other countries." However, he sees no need for the change at this time. Another interesting suggestion for far-reaching change is his proposal for eliminating the tax advantages of the use of trusts. Unfortunately, this proposal is stated with a disturbing lack of clarity and detail. His basic idea is that the grantor of a trust should be taxed on its income unless he has made a complete and final transfer to another single individual; in addition he seems to suggest that the beneficiary of a trust should be taxable on its income regardless of whether that income is distributed. While the idea does not seem to have been worked out too well, it does seem worthy of serious consideration.

It is in his discussion of such matters as capital gains, restricted stock options, depreciation, and the dividend credit that Smith's basic philosophy manifests itself most strongly. His proposals in these areas are by no means untenable. It is his reasoning and his lack of diffidence in making those proposals which, in my opinion, are objectionable.

Smith states that "it is hard to imagine any single change in the tax law which would do as much damage to economic development as the full taxation of capital gains . . . ." The statement may seem rather extreme, but at the

23 P. 46. 24 P. 221. 25 Ibid. 26 P. 146.
same time seems to make a good deal of sense. In the absence of proof to the contrary, I for one would be unwilling to risk the possible consequences of disregarding it. The real question is, how far can we go in taxing capital gains? Smith does not equivocate. He states, in typically unrestrained fashion:

The present 25 per cent maximum is probably the highest which could be imposed without serious curtailment of investment in new ventures and other high-risk fields. This is not subject to proof a priori, but a chance to retain three-quarters of a profit sounds a good deal more attractive than a chance to retain, say, only two-thirds of a profit.²⁷

Those who are not thoroughly persuaded by this reasoning need not be concerned. The author's proposal for a change in the rate of taxation of capital gains is placed on a different ground—the largely unproved but possibly self-proving "freezing" hypothesis. This notion, that the tax discourages the sale of property on which a substantial gain "has developed,"²²⁸ leads to two suggestions. The first is for a return to a tax which decreases as the holding period increases, eventually reaching a maximum rate of 12½ per cent. But in contrast with other adherents of the "freezing" hypothesis, Smith would shorten, rather than lengthen, the minimum holding period. In sum, his proposal is for "an increase in the minimum holding period to one year with a 37½ per cent maximum rate on holdings of one to three years, 25 per cent on holdings of four to ten years, and 12½ per cent on holdings of over ten years."²²⁹ Thus it can be seen that his proposal is not of the anti-tax sort which one usually associates with the kind of premises upon which he relies; undoubtedly it would find widespread support. His second suggestion, by no means as conservative, would permit a tax-free roll-over of investments with withdrawals of gains taxed as ordinary income. He concedes, however, that this proposal may be administratively unfeasible. I imagine that experienced tax lawyers would have a field day if a proposal of this sort ever became the law; avoidance of capital-gains tax would rank with percentage depletion and restricted stock options as leading tax-saving devices. As long as the practical problems remain unsolved (and I doubt that they can be solved), it seems unnecessary to consider the theoretical merits of the roll-over proposal.

As for restricted stock options, Smith not surprisingly assumes that, wholly apart from tax considerations, they are uniquely useful incentive devices.³⁰ However, he is sufficiently concerned with abuses that he favors a substantial tightening of the present rules. Basically he proposes a long holding period

²⁷ P. 145.
²⁸ P. 146.
²⁹ P. 147.

³⁰ A noteworthy recent article draws on past experience to cast considerable doubt on this assumption. Wallace, Should We Continue to Encourage the Use of Restricted Stock Options, 39 Taxes 785 (1961). The author also attempts to demonstrate that the tax advantages of the use of such options may well be overrated.
with the executive's own capital at risk. This eminently sound proposal might well sound the death knell for the use of this form of compensation.

Also not surprising are Smith's views on the depreciation deduction. He regards the present allowances as woefully inadequate. One of his more intriguing suggestions is that depreciation for tax purposes should not be allowed to exceed depreciation for ordinary accounting and public reporting purposes. The basis for this proposal seems to be the somewhat startling assumption that businessmen behave irrationally. He assumes a widespread reluctance to retire assets which have not been fully depreciated on the books. His goal is to encourage faster replacement of capital assets. Therefore, he says, we should permit more rapid tax write-offs; if his proposal were adopted, this would result in faster book write-offs and, by hypothesis, more rapid replacement. I must confess that I am somewhat taken aback by the hypothesis of irrational conduct. If businessmen are this irrational (which I doubt), then I would seriously question Smith's views as to the desirability of tax laws which encourage the use of retained earnings, by corporations, as a source of funds for expansion.

In many parts of the chapter on depreciation it is difficult to determine just what Smith's point is. But I found myself somewhat troubled by his statements on the significance of cash flow; on the relationship between the availability of modern equipment and the replacement of existing equipment; on the relationship between European competition and domestic depreciation policy; and on the relationship between the depreciation deduction and the availability of funds for replacement. Indeed, the entire chapter on depreciation seems to me more likely to impede than advance the cause of public enlightenment.

In spite of its shortcomings (or perhaps I should say of the differences between Smith's views and my own) I would not hesitate to recommend the book most highly, on one condition: that is, that the inexperienced reader should adopt an attitude of skepticism, ideally by fortifying himself with study of *The Ideologies of Taxation*.

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