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 tﾄ ﾐﾓﾓﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ｰ弭Kﾓ・4澀oodafternoon!MynameisProfessorﾔ\_ﾔGeierﾔ\_ﾔтrhymeswith"tire"тandI'mvery,ﾏverypleasedtobehere.You,ontheotherhandтatleastsomeofyouтmight・ot・besoﾐ  
 L ・ ﾐpleasedtofindyourselfinataxclass.IhopethatthematerialintheIntroductionthatyouﾏreadfortodaydispelledsomeofyourmisconceptionsandanxieties,oratleastconfirmedﾏtoyoutheimportanceofthecourse,notwithstandingyourmisgivings.I'llreturntothatinﾏamoment.ﾌ・4澳inceI'mavisitorthissemester,andthereisthusno"receivedwisdom"frompriorﾏgenerationsoflawstudentshereregardingwhoIamandwhatI'mlike,I'dliketotellyouﾏalittlebitaboutmybackground.IgraduatedfromCaseWesternReservelawschoolinﾏmyhometownofCleveland,afterpracticingfor7yearsasaregisterednurse,helpingtoﾏdeliverbabiesinalargelaboranddeliveryunit.WhenIwenttolawschool,Iexpectedﾏthatthepracticalthingformetodowouldbetocombinemymedicalbackgroundwithﾏlaw,butbytheendofmysecondyearoflawschool,IknewboththatIwantedtoﾏconcentrateontaxandthatIeventuallywantedtoteach.ﾌ・4漓ftergraduatingfromlawschool,IclerkedforMonroeG.ﾔ\_ﾔMcKayﾔ\_ﾔintheTenthﾏCircuit,whichsitsinDenver(thoughmyjudge'schamberswereinSaltLakeCity).AfterﾏmyclerkshipIpracticedwiththetaxgroupatSullivan&CromwellinNewYorkCity,ﾏfinallyjoiningacademiain1989atthe"other"lawschoolinmyhometown,ClevelandﾏStateUniversity.IhavealsovisitedattheUniversityofFloridainGainesvilleandnowﾏhere.IteachBasicTax,CorporateTax,InternationalTax,theTaxationofCorporateﾏReorganizations(whichIamteachingherethissemester),andтforfunтacourseinﾏFederalIndianLaw,aﾔ\_ﾔnontaxﾔ\_ﾔcourse,aninterestsparkedduringmyclerkship.ﾌ・4滷eforemyco・uthorsandIwrotethecasebookthatwe'llbeusingforthiscourse,ﾏIusedtousethefirstclasstotalkaboutthosethreemythsthatyoureadaboutintheﾏIntroduction.(OneofthedownsidesaboutwritingacasebookisthatalotofthestuffﾏthatIusedto"explain"tostudentsinclass,whichwasnotinthecasebook,usedtomakeﾏmelookbrilliantandagodsend.Sinceweconsciouslydecidedtotrytousemuchmoreﾏtextualexplanationthanistypicallyseeninmostbooks,I'mmuchlessneededbystudents,ﾏmuchmoresuperfluous.Ohwell.)ﾌ・4澣hebestevidenceofMythNumber1тthatpeoplewithanaccountingorbusinessﾏbackgroundsomehowhaveanadvantageoverliberal・rtsmajorsтisME.AsIsaid,Iwasﾏaregisterednurse.MyundergraduatemajorwasPsychology.ﾌ・4潛'malsothebestevidenceofMythNumber2тthattaxlawisaboutcomputations.ﾏIamlivingproofthatyoudon'tneedtobegoodatmathtobeataxlawyer.IcanjustﾏaboutpromiseyouthatatsomepointIwillmakematherrorsontheboard.(Pleasedon'tﾏhesitatetopointthemoutto・ﾖ・

ﾖ・ﾖ・ewhenthetimecomes.)Asthetextsays,basicaddition,ﾏsubtraction,multiplication,anddivisionareallthatisnecessary,andthereasontheyareﾏnecessaryisonlytoillustratethe・oncepts・thatcomprisetaxlaw.Justasanyotherareaofﾐ  
 |\*ﾌ%) ﾐlaw,taxlawisconceptual.Itisnotsimplyabunchofrulestobememorized.Thereisaﾐ  
 h+ｸ&\* ﾐlargerstructureouttherearoundwhichtheInternalRevenueCodeisbuilt.Ourjobistoﾏexplorethatstructure,andthoughsimplenumbersaregoingtobenecessary,theyarenotﾏﾔ\_ﾔoverwhelming.Indeed,asthetextsays,thestudentwhofailstosubtract$40,000fromﾏ$100,000toarriveat$60,000doesnotusuallyhaveaproblemwithmathorbusinessﾏacumen(thoughthestudentmayseethatastheproblem)butratheramorefundamentalﾏproblemwithpickingapartthestatutorylanguagethatdirectshimtosubtract$40,000ﾏfrom$100,000.ﾌ・4漓syoureadinconnectionwithMythNumber3,thiscourseisimportantevenforﾏthemajorityofyouтperhapseachandeveryoneofyouтwhohavenodesiretobecomeaﾏ"taxlawyer."Eachofyou,nomatterwhatareaofthelawyouwillpractice,willneedtoﾏbeproficientinreadingstatutesandneedtobefamiliarwithhowtoanalyzestatutoryﾏlanguageonceyoumasteritsreading.ThetextualmaterialinthebookoftenintroducesﾏyoutothematerialcontainedintheCode,butwhenansweringtheproblems,youmustﾏturntothespecificstatutoryandregulatorylanguagethatapplies.SecondarysourceﾏdescriptionsofwhatiscontainedintheCodeareusefultostudents(andpractitioners)forﾏprovidingaframeworkwithinwhichaparticularproblemcanbeputincontext,buttheyﾏdonotobviatetheneedtodevelopskillsinreadingandapplyingstatutorylanguageandﾏrelatedadministrativematerial.ﾌ・4潼oreover,thereisjustaboutnoareaofthelawuntouchedbytaxlaw.Youneedﾏtoknowthefundamentals;youneedatleasttobeawarewhentogetataxlawyerﾏinvolved.Ifanyofyoudoendupspecializingintax,youwilllearntohateitwhenaﾏclient,oraﾔ\_ﾔnontaxﾔ\_ﾔlawyerinyouroffice,comesintoyourofficeandsays,"ThisiswhatIﾏdid."Andyoucringe,becauseyouknowyoushouldhavebeenbroughtinearlier.ﾌ・4澣hatbringsmetosomethingwedon'ttalkalotaboutinthebook:Whatdotaxﾏlawyersreallydo?MostlawstudentscomingintoBasicTaxhavehugemisconceptionsﾏabouttaxlawyers.Theythinkweweargreeneyeshadesandsitatadeskfillingouttaxﾏreturns.Somethinkthattaxlawisadefinitebodyofknowablelaw,afirmsetofrulestoﾏlearn.Oncethey'relearned,that'sit.Theyfillouttaxreturnsapplyingthelawtotheﾏclient'ssituation.Itisquiteacommonﾔ\_ﾔmisperceptionﾔ\_ﾔ.HaveanyofyoureadJohnﾏﾔ\_ﾔGrishamﾔ\_ﾔ's"TheFirm"?Orperhapsseenthemovie?Fortheuninitiated,Johnﾔ\_ﾔGrishamﾔ\_ﾔisﾏhimselfalawyer,agraduateofOleMiss.Andyethewrotethefollowing,regardingtheﾏworkofaboutiquetaxfirm:[readfirstparagraphofChapter29].ﾌ・4漓goodread,butabsolutelyridiculous.Iwouldbeamess,too,atthethoughtofﾏfillingoutallthosetaxreturns.Rememberthatotherprofessionтaccounting?(Bytheﾏway,ifanyofyouareinterested,thereisawonderfulbookreviewofTheFirmpublishedﾏafewyearsbackinthePennsylvaniaLawReview,writtenbymymentor.It'scalled,"TheﾏHeroicNatureofTaxLawyers,"anditsaysthatitisabouttimethattheherowasataxﾏlawyer.I'veputacopyonreserveinthelibraryifyouareinterested.Someprofessorsatﾏotherschoolsmakeitrequiredreadingfortheirbeginningtaxstudents.)ﾌ・4澣heonlytaxreturnIhaveeverfilledoutismyown,andIknowtaxlawyerswhoﾏdon'tevenfillouttheirown.Taxlawyersare,forthemostpart,planners.Theydealwithﾏtransactions,whetherthetransactionisapersonalone,suchasadivorce,orabusinessﾏone,suchasacorporatereorganization.TheyaretypicallynobusieraroundApril15thanﾐ  
 h+ｸ&\* ﾐanyothertimeoftheyear.Theyattempttodevisethebestapproachtostructuringtheﾏtransactionthatwillsatisfytheclient'spersonalandbusinessneedsinawaythatisalsotaxﾏefficient.Itisthusverycreativeandforward・ooking.Taxlawyerstypicallytrytokeepﾏtheirclientsoutofcourt.YoureadaboutonemeansfordoingthatтtheprivateletterﾏrulingfromtheIRS.Butforthosewholiketheideaofalittlelitigation,thereisofcourseﾏlitigationintaxaswell.Andtypicallytherearetaxlawyersinvolvedintaxlitigation.Theﾏmatterisn'tsimplyturnedoverentirelytothelitigationdepartmentifitcomestothat.ﾌ・4澹hataboutthestructureofthiscourseinparticular?Iwantyoutopickupaﾏsyllabusonthewayout.Ratherthanwasteclasstime,Ihavememorializedonpaperhowﾏthecoursewillbestructuredforyoutoreadinyourleisure.ThoughI'mdoingmostofﾏthetalkingtoday,IdocallonstudentsтnotbecauseIwishtointimidateyoubutbecauseIﾏwishforyoutodevelopyourskills.Learningisnotaspectatorsport,inmyview.Ittakesﾏefforton・oth・ourparts.Acollaborativeeffortamongusbearsthebestfruit.AndIﾐ  
 ﾀ  
 ﾐrememberwhatitisliketobeastudent.Ihadoneprofessorinlawschoolwhoonlyﾏlectured,nevercalledonstudents.Theresult?Rarelydidstudentspreparediligently,ifatﾏall,forthatclass.Andtheydidn'tlearn.Iwillpassaroundaseatingcharttomorrow,soﾏpleasesittomorrowwhereyouwishtospendthesemester.ﾌ・4潼yofficeis925ﾔ\_ﾔLRﾔ\_ﾔ,inthestacks,andI'llbeherealldayeverydayMondayﾏthroughThursday.Iwill,unfortunately,havetocancelourclassesonWednesday,ﾏOctober9,andThursday,October10.Iapologizeforthat,butIagreedalongtimeagoﾏtoparticipateinataxprogramonthosedays.Ireservetherighttoschedulemakeеpﾏclasseslaterinthesemester,dependingonhowwemovethroughthecourse.Ifwedon'tﾏneedthetime,we'llletitgo.ﾌ・4潛teachfrom9・0onTuesdayandWednesdaymornings,andIaskthatyouleaveﾏmethehourbeforethisclassfreeformyownpreparation,butotherwisefeelfreetostopﾏbyatanytimeifyouhavequestionsorarehavingdifficulty.ButIhopethatyouaskﾏquestionsthatyouhaveinclassaswell.Ifyouhaveaquestion,morethanlikelysomeoneﾏelseintheclasshasthesamequestionandcanbenefitfromhearingmyresponse.ThereﾏmaybetimeswhenIthinkthatlittlefurtherbenefitcancomeofadiscussionwhenalltheﾏbasicpointshavebeenmade,orwe'regettingrepetitive,ortherestoftheclassisreadytoﾏmoveon,andI'llsaytoastudentwhowantstopursueitfurtherthatweshoulddosoinﾏmyoffice.Butthatdoesn'thappentoooften.(Andifitdoes,pleasedon'ttakeitﾏpersonally.Isometimeshavetomoveonbecauseitissimplymyjobtopacethecourse.)ﾌ・4澳olet'sgettoit!ﾌ・4澆hapter1isdevotedentirelytoacquaintingyouwiththetoolsoftaxpolicy.TheﾏFederalGovernment,throughCongress,hasdecideditneedstoraise$X.・owshouldtheﾐ  
 ・D # ﾐburdenof$Xbeallocatedacrossthepopulation?・Thatisthemillion・ollarquestion.Iﾐ  
 ・0!$ ﾐdon'tcarewhat$Xis.Becauseoftherhetoricofourpoliticians,moststudentsareusuallyﾏsurprisedbyfootnote1onpage17.Combiningfederal,state,andlocaltaxes,weareﾏtaxedlessheavilythanalmosteveryotherindustrializednation.Butitreallydoesn'tﾏmatterwhat$Xis.Youcanalldecidethat$Xistoohighandshouldbereducedbyoneﾏ・

穢uarter,oronehalf,thoughthatisextremelyunlikelytohappen,sinceAmericansarenotﾐ  
 |\*ﾌ%) ﾐwillingtoacceptthespendingcutsinmiddle・lassentitlementsthatwouldbenecessaryﾏforsuchaslashingoftaxrates.ﾌ・

籵4漓samatteroffact,$X,asanoverallnumber,hasremainedvirtuallyunchanged,ﾏfluctuatingwithinaverynarrowmargin,inthelast30years.Duringthattime,$Xhasﾏneverfallenbelow17.2%ofnationalincome(grossdomesticproduct)norexceededﾏ19.7%.Thisyear,we'reat19.1%.(AndtheDoleproposals,shouldtheybecomelaw,ﾏwouldnotbreakthebounds.Itwouldlowertheamountto17.5%by2002.)ﾌ・4澳owhat'sallthefussif$Xstaysaboutthesameandisunlikelytochangeﾏdramaticallyinthenearfuture?Nomatterwhat$Xis,westillhavetodecidehowtoﾏallocatetheburdenof$Xamongthepopulation.Andthatallocationdoeschangeﾏdramatically.TherearemultiplesourcesofFederaltaxes:individualandcorporateﾏincometaxes,SocialSecurityandMedicaretaxes,gasolineandcigarettetaxes,andahalfﾏadozenothertaxes.Whenonetaxgoesdown,anothergoesup.Anddistributionoftheﾏburdenwithintheincometaxitselfcanchange.Thus,whoamongusshoulderstheburdenﾏof$Xchangesallthetime,andthatisreallywhattaxpolicyisallabout,becausehowyouﾏdefinethetaxbaseandthetaxratestructurewilldeterminehow$Xisallocated.ﾌ・4潦ememberalwaysthatwhenyoudecidethatAshouldgeta"taxbreak,"thattaxﾏbreakispaidforbyB,C,etc.Youcan'tlookatAinisolation,since$Xisgoingtoﾏremainthesame.Andhowthefederaltaxburdenisallocatedamongthepopulation・as・  
 H・ ﾐchangeddramaticallyduringthelastthirtyyears.Forexample,accordingtotheﾏCongressionalBudgetOffice(candescribehow1986destructionoftaxsheltersplayedﾏintothenumbershere,aswellas91and93toprateincreases):ﾌﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森TﾓﾌEffectivetaxratesforﾌtop20%(averageincomebottom20%(averageﾌ$124,000in1996dollars)income$8,700)ﾌlate1970s27.2%9.2%ﾌ198524.1%10.4%ﾌ199628.1%5.0%ﾌﾌﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ﾜ店Kﾓ・4澳othequestionbecomes:Whattoolscanweusetodecideinarational,orderedﾏwayhowtoallocate$X,whateveryouthinkitshouldbe,amongus?Thechapterﾏdescribestwobroadsetsoftaxpolicynormsthatcanhelpusgrapplewiththisnever┥endingdebate.Whatarethey?Economicnormsandfairnessnorms.Thesenormsareﾏofteninconflictwitheachotherorareofteninconflictwithotherimportantvalues:ﾏsimplicityandﾔ\_ﾔadministrabilityﾔ\_ﾔ.Whenyoudisagreeamongyourselvesaboutthewisdomofﾏaparticularkindoftaxsystem,oraboutthewisdomofparticularprovisionswithintheﾏincometaxsystemitselfтassurelyyouwillтyouarereally,underneathit,disagreeingﾏaboutthestressthatoughttobegiventooneoranotherofthesenorms.Solet'smakeﾏthesenormsexplicit.ﾌ・4瑣conomicnorms・・Thebigeconomicnormistheneutralitynorm.Whatdoesthatﾐ  
 ・・( ﾐmean?Itmeansthatataxorprovisionshouldinterferewithbehavioraslittleaspossible.ﾏWhy?Whatisthevalueofthat?Isitjustourspiritoflibertyтthatgovernmentshouldn'tﾐ  
 h+ｸ&\* ﾐcoerceyouintocertainbehaviorsordiscouragecertainbehaviorsthroughmanipulationofﾏthetaxcode?Perhapsthereisagrainofthat.Butthereasonthisiscalledaneconomicﾏnormisthatitisbasedonourbeliefsaboutoureconomicsystem:free・arketcapitalism.ﾏWebelievethattotalwealthwillbemaximizedinsocietyifgoodsandservicesarefreetoﾏflowtotheirbestuses.IfwetrytodirectwhereitshouldgoтasinthecentralplanningﾏsystemsoftheformerSovietUnionтtotalnationalwealthwillbeless.Thetouchstoneofﾏfree・arketcapitalismis"efficiency."The"invisiblehand"ofthemarketplacewillﾏoperatetomaximizeaggregatewealthifwejustletgoodsandservicesnaturallyflow,ﾏwithoutinterference,totheirhighestgoodsanduses.Undertheneutralitynorm,weﾏwouldnothavetaxincentivestoencouragechangesinpeople'sbehavior,sincethatisﾏassumedtoloweraggregatewealth.Wewouldn'ttaxdifferentkindsofincomes(e.g,ﾏ"capitalgain")differently.Wewouldhaveabroadbaseтfewdeductionsorexclusionsтsoﾏthatwecouldhavelowratesandstillcollect$X,sincethelowertherates,thelesslikelyﾏtaxeswillinterfereinthestructuringoftransactions.(Givepassivelossexamplein1986.)ﾌ・4澹hileneutralityisthebignorm,theneutralitynormpresupposes"elasticity"тthatﾏbehaviorcaninfactbeaffectedbythegovernmentinterventionandshouldnotbeтbutﾏsomeitemsaren'telastic.(E.g.,thegovernmentcangetawaywithhighertaxesongasﾏconsumptionbecausegasconsumptionisrelativelyinelastic.)Thus,the"optimaltaxation"ﾏtheorystepsintoarguethatrelativelyheaviertaxation(whichsuperficiallyseemstoﾏviolatetheneutralitynorm)isdesirablewithrespecttoinelasticgoodsbecausesuchﾏtaxationwillnotsignificantlyaffectbehavior.Anothertwist:taxesdon'toperateinaﾏvacuum.Thepolicyanalystmustconsiderothergovernmentinterventionsundertheﾏtheoryofthesecondbestaswellasmarketfailures.(E.g.,ifthereisnotenoughsavingsﾏinU.S.,thefaultmayliewiththeSocialSecuritysystem,easyconsumercredit,・tc.・・notﾐ  
 ・4 ﾐthetaxsystem.)Wecan'texpectthetaxsystemtosolveallproblems.ﾌ・4滷utweallknowthatwe・o・interfereinthemarketplaceinsituationsinwhichweﾐ  
 ｼ ﾐbelievetherearemarketfailures.Andwemightdecidetointerfereiftheincreaseinﾏaggregatewealthflowsentirelytooneperson.Andwehaveallkindsofincentivesandﾏspecialtaxratesandspecialdeductionsforcertainkindsofbehaviorтwhathavecometoﾏbeknownas"taxexpenditures,"asdescribedinyourtext.Onewaytoanalyzethesewhileﾏstayingonthe"economic"sideoftheboardistoreject"neoclassiceconomics,"whereﾏefficiencyandthusneutralityisking,infavorof"welfareeconomics,"whereyouwouldﾏmeasuretheeconomiccostsandbenefitsofaprovisionandadoptitiftheaggregateﾏbenefitsoutweighedtheaggregatecosts.Whenwegettothecharitablecontributionﾏdeduction,forexample,we'llseethatﾔ\_ﾔthatﾔ\_ﾔisataxexpenditurethatcanperhapsbeﾏdefendedunderacost・enefitanalysis,eventhoughitclearlyviolateseconomicneutrality.ﾏAndthatapproachmayhelpuscritiquethestructureofthedeductionprovision.Butﾏmeasuringsuchcostsandbenefitsisadauntingtask,andwelfareeconomicsisnotterriblyﾏrespectedthesedays(eventhoughithasnothingtodowith"welfare"intheAFDCsenseтｼitissimplyanotherschoolofthoughtwithintherealmofeconomics).Thatbringsustoﾏfairnessnorms.ﾌ・4瑣airnessnorms・・Thetwomostcommonlytalkedaboutfairnessnormsinotherﾐ  
 |\*ﾌ%) ﾐbasictaxtextbooksare"horizontalequity"and"verticalequity."Butatbottom,theyﾐ  
 h+ｸ&\* ﾐreallydon'tanswermuch."Horizontalequity"meansthatsimilarlysituatedtaxpayersﾏshouldbetaxedsimilarly.Butwhatis"similarlysituated"?Perhapsthetwopersonsreallyﾏareindifferentsituations.Andiftheyreallyareinthesamesituation,andPerson1isnot,ﾏforexample,gettingadeductionthatPerson2gets,thenormdoesn'ttelluswhethertoﾏtakethedeductionawayfromPerson2orextendittobothpeople."Verticalequity"isﾏusuallycitedasashorthandwayofsayingthatthosewithmoredisposableincomeshouldﾏpaymorethanthosewithless.Weexplorethisinmoredetailinalaterchapterlookingatﾏourprogressiveratestructure.Doesn'ttellusmuchelse,though.ﾌ・4澳oweneedtogofurther,tothe"abilityдoаay"normandthe"standard・f・iving"ﾏnorm.Youcancallthesetwodifferentnormsof"taxjustice."Rememberthatweareﾏtryingtogetattheproblemofdetermininghowtoallocatetheburdenof$Xacrossﾏindividualsinthepopulation.Thesetwonormsoffercompetingmodelsforthatﾏdistribution.Theabilityдoаaynormhasheavilyinfluencedtheincometax,usuallytakingﾏprecedenceoverthestandard・f・ivingnorm.ﾌ・4澡ndertheabilityдoаaynorm,welooktoresourcesunderthecontroloftheﾏtaxpayerthatareavailableforcontributiontothefisc.Undertheabilityдoаaynorm,bothﾏamountsspentonpersonalconsumptionandamountssaved(callit"netwealthincreases")ﾏshouldenterthetaxbase,asbothrepresentabilitytopay.Briefly,the"standard・f・iving"ﾏnormlookstosomemeasureof"utility,"suchasenjoyment,inmeasuringthetaxbase.Itﾏisobviouslyamoreephemeralmeasure,butunderthestandardoflivingnorm,wewouldﾏprobablycarveoutsavings,taxingonlyconsumption,howevermeasured.Itsays,inﾏeffect,thatwewilltaxyoudependingonhowhighonthehogyoulive.Sincethetopﾏ20%hasmoredisposableincome(andthusgreaterabilitytosave),adecisiontotaxonlyﾏconsumptionshiftsthetaxburdendownward,sincetherelativelypoormustspendmostofﾏtheirincomeoncurrentconsumption.ﾌ・4澣heideaofreplacingtheincometaxwithaconsumptiontaxisabigonetheseﾏdays,andwe'lltakealookatitmorecloselyinalaterchapter.Oneofthereasonstotalkﾏaboutthisdistinction,eveniftheincometaxisneverreplacedwithaconsumptiontax,isﾏthatourcurrentincometaxhasmanyconsumptionдaxfeatures.Itisreallyahybridﾏbetweenapureincometaxandaconsumptiontax.OneexamplewithwhichyouareﾏfamiliarisIRAs.Itisaformofsavings,andyetitescapestaxationundertheincometax,ﾏjustasthoughourtaxsystemtaxedonlyconsumptionandnotsavings.Thisminglingofﾏconsumptiontaxfeaturesinourincometaxisanotherpervasivethemeofthecourse.Stayﾏtuned.ﾌﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森Tﾓﾌ・澡nderbothincomeandconsumptiontaxes,anotherpervasivethemeis"howshouldﾐ  
 ・D # ﾐwemeasureconsumption?"Shoulditbemeasuredbytheobjectivevaluereceived,ﾏsubjectivevaluereceived,oramountspentonit?(Standard・f・ivingvs.abilityдoаayﾏconceptsmighthelpusanswerthat.Again,staytuned.)ﾌﾌ・潛nProblem1(p.29),themainissueiswhetherthetwotaxpayersshouldbearthesameﾏtaxburdenbecauseofequalgrossreceipts.Aretheyinthesameposition?Doestheﾏneutralitynormhelp?ﾐ  
 h+ｸ&\* ﾐﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ﾜ店Kﾓ・4漓retheyinthesamepositionifthetaxbaseis"income"justbecausetheyhaveﾏequalgrossreceipts?Undertheeconomicﾔ\_ﾔdefinitonﾔ\_ﾔof"income"definitionthatyoureadﾏabout,income=netwealthincreases+consumption.Ifthatisthetaxbase,shouldﾏamountsspentonbusinessexpensesbedeductible?Itisadecreaseinwealth.Butareallﾏdecreasesinwealthdeductible?Notifitrepresentsconsumption.Whatdowemeanbyﾏ"consumption"?Howabout,"thedestructionofeconomicgoodsandservices"?Totheﾏeconomyasawholeortothetaxpayer?Thetaxsystemlookstothetaxpayer,nottheﾏeconomyasawhole.Theexpensesinisolationentaildestructiontothetaxpayer.Orisﾏ"consumption"destructiontothetaxpayerforhisorher"personal"benefit?Thisseemsﾏplausible.Ormaybeit'sjustanyoutlaythatisnotmadedirectlyinpursuitofmakingﾏmoney.Sobusinessexpenses,asanetdecreaseinwealththatisnotconsumption,shouldﾏbedeductibleundertheSЗТnotionofincome.Thus,itappearsthatJaneandSueareﾏnotinequalpositions,notwithstandingthattheyhaveequalgrossreceipts.ﾌﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森Tﾓﾌ・澣hedeductionforbusinessexpensescanalsobeexplainedwithreferencetotheﾏneutralitynorm.Wecouldmakethepointdramatically.WhatifSueweretaxedata30%ﾏrateongrossreceipts?Thetaxwouldbegreaterthanwhatsheendsupwithforherselfﾏ($10,000).Thus,thetaxongrossreceiptswouldmeanthatlotsofprofitableandﾏbeneficialactivitywouldneverbeundertaken,violatingtheneutralitynorm.(Atleastﾏwherethetaxrateequalsorexceedsthe"normal"rateofbeforeдaxreturn.)ﾌﾌﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ﾜ店Kﾓ・4濕Thefollowingpar.isconfusing,considerskippingit.Thedoubletaxpointisﾏmoreclearlyillustratedwiththerecoveryofbasisinthenextchapter.]ﾌ・4猯・4滷utisreallyjustamatterofincentive?Doestheincometaxallowbusinessﾏexpensedeductionsasanincentive,toencouragebusinessactivitycomparedtoﾏconsumptionactivity?Perhapsnot.Trythis.Undertheneutralitynorm,doubletaxationﾏofthesamedollarstothesametaxpayerisanathema,becauseitdiscouragesengagementﾏinthebehaviorresultinginthedoubletaxation(assumingthebehavioriselastic).Inaﾏway,taxinggrossreceipts,whichincludestheamountspentonbusinessexpenses(bynotﾏdeductingthem),entailsdoubletaxationofthoseexpensesinaloosebuthighlyrelevantﾏsense,becausetheessentialfactisthatbusinessexpensesareundertakeninordertoﾏgenerateatleastthatmuchinreceipts.Taxingboththe"means"toproducegrossreceiptsﾏandthe"ends"themselves(theprofits)arguablytaxesthose"means"twice.So,deductingﾏbusinessexpensesisaimednotsomuchtoprovideincentiveforbusinessbuttoremoveﾏpotentialdisincentive(infavorofconsumption,whichistaxedonlyonce)undertheﾏneutralitynorm.Thus,thedenialofexpensedeductionsforillegaldrugtraffickingviolatesﾏtheneutralitynormintentionally.・ee・・280E.Thisdifficultnotionisexploredinthetextﾐ  
 ﾌ&"% ﾐforyoualittlemorefullyinthenextchapter(Chapter2,PartD).ﾌ・4猯・4澣hebottomlineisthatifwearetotax"income"andnot"grossreceipts,"wemustﾏallowadeductionofoutlaysincurredtoproducethosegrossreceipts,sothatonlynetﾏprofitistaxed.ﾐ  
 h+ｸ&\* ﾐﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森Tﾓﾌﾔ\_ﾔﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ﾜ店Kﾓ・4漓sanaside,shouldwantoneconomicwaste(suchasresultsfromcertainkindsofﾏ"taxshelters"),whichrepresentsadecreaseinwealth,betaxed(bypreventingaﾏdeduction),evenifnotcharacterizedas"consumption?"WithrespecttoSue'sandJane'sﾏbusiness・xpensedeductions,weconcentratedontryingtodefine"consumption."Sinceﾏtheiroutlaysweren't"consumption,"theyshouldbedeductibleunderanincometax.Taxﾏshelterlossesmightnotsatisfyanyofthedefinitionsof"consumption"wecameupwith.ﾏNevertheless,theamountwasteddidrepresentabilitytopay.Withoutnecessarilyﾏresolvingthisissuenow,Iwantedtopointoutthattheconceptof"personalconsumption"ﾏmaynotfullyencompasstheproblemofwhatshouldbetaxed.Inotherwords,insteadofﾏstrainingoverdefinitionsof"consumption"inmarginalcasesтandwe'regoingtoconsiderﾏsomemarginalcaseslateronтoneshouldlooktounderlyingnorms.Asamatterofwhatﾏpositivelawshouldbe,thequestionisnotreallywhethertheitemis"income"orﾏ"consumption"butwhetherit"should"betaxed,usingthenormswehavebeendiscussing.ﾌﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森TﾓﾌﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ﾜ店Kﾓ・4濕Moreover,theanalysissupportingadeductionforbusinessexpensesundertheﾏneutralitynormsuggeststhatwantoneconomicwasteshouldbesubjecttotax,・.e.・・notﾐ  
 pﾀ ﾐdeducted.Unlikebusinessexpenses,suchwasteisnotreallyaimedtoproducecurrentorﾏfutureincome,sotaxingtheseamountswouldnotentaildoubletaxation.]ﾌﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森Tﾓﾌ・潛sdeductionofbusinessexpensessacrosanctoutsidethetaxгheltercase?Canweﾏneverdisallowbusinessexpenses?Whataboutbusinessmeals?(Somebusinessexpensesﾏlooklikeconsumption.)Expensesofemployees,likebusinesssuits?Educationexpenses?ﾏAsapreliminarymatter,disallowingdeductionsforsuchmarginalitemswouldnothaveﾏthesameconsequencesasadoptingagrossreceiptstax.We'lldealwiththeseissuesinﾏduecourse.ﾌﾌ・滷usinessexpenseswouldbedeductedunderbothanincometaxandaconsumptionﾏtax.Indesigningthesetaxes,itisimpracticaltoaddupconsumptionoutlays(andﾏincreasesinwealth).Underbothtaxes,youstartbyaddingupreceipts,suchaswages,ﾏinterest,anddividends.Thenyoutakecertaindeductions.(Ifyouareinterested,IhaveﾏincludedahandydandyroadmapfromGrossIncometoTaxDueasthelastpageofyourﾏsyllabus,thoughyouwouldneverbeaskedtocomputethetaxdueforataxpayer.)Bothﾏsystemsallowdeductionofbusinessoutlays.Underanincometax,youdon'tdeductﾏincreasesinwealth(amountssavedandinvested);underaconsumptiontax,youdo.ThisﾏleadstoProblem2.ﾌﾌ・潛nProblem2,bothtaxpayersget$60,000,butJoeBobsaves$10,000.Shouldthatﾏ$10,000betaxed?Horizontalequityanalysisbegsthatcrucialquestion.Abilityдoаayﾏvs.standard・f・ivingconceptsproducediametricallyopposedanswers(yesandno).TheﾏVictorianideathatconsumptionismorallybadandsavingsisgoodispersistent.Isﾏconsumptionreallybad?Doesn'toureconomyabsolutelydependonconsumption?Doﾏdollarsspentonconsumptiondisappear?Anyeffectonsocialwelfare?(Exchangetheoryﾐ  
 h+ｸ&\* ﾐholdsthatallmarkettransactionsaddtoaggregatewelfare,ifwedisregardnegativeﾏexternalities.)Soconsumptionmightnotreallybesobad.It'struethatsavings(・.g.,・  
 ・・・an・produceaﾐ  
 L ・ ﾐnetsocialgainiftheborrowedmoneyisinvestedinproductiveactivitythatyieldsaﾏgreaternetreturnthaninterestexpense.Ofcourse,notallactiveinvestmentsinfactﾏcreatesocialwealth,butweshouldinitiallygiveentrepreneursthebenefitofthedoubtﾏwherethereisaseriousattempttomakeprofits.ﾌﾌ・澳upposewedecidedthatthenationdoesneedmoresavings.Thefirstpointtoﾏmentionisthattaxlawdoesn'thavetobearthefullburdenofthispolicy,asit'snota"tax"ﾏissue.It'salargerpolicyissuethatcanusetoolsotherthanthetaxsystem.Someﾏeconomistssaythatifwecouldonlyreduceournationaldebtandthusreducetheamountﾏofinterestthefederalgovernmentmustpayonthatdebt(freeingupmoneyforotherﾏuses),thatour"savings"crisiswoulddisappear.Andthesecond・esttheorythatyoureadﾏaboutstepsinhere.Rememberthatthattheorypositsthatanactiondirectedatonegoalﾏmayactuallyhavetheoppositeeffectandthusitmaybe"secondbest"tohavewhatﾏappeartobe"twowrongs."Perhaps,forexample,agovernmentactiontoincreaseﾏpersonalsavings(・.g.,・investmentinadebtsecurity)wouldn'tbebeneficialbecausetheﾐ  
 p ﾐcorrespondingborrowingbytheotherpartytothesavingsisusedforpersonalﾏconsumption(oriswasteful).Thatis,underthetheoryofthesecondbest,wemightﾏactuallymaintainahighersavingsratewithoutthegovernmentinterventiondesignedtoﾏincreasesavings.ﾌﾓK7ﾜﾜ4・・<・・D・・L､­・T$ｬ&)\+ﾜ店Kﾓ・4澳econd,assumethatwedousethetaxlawtotrytoincreasesavings:Willaﾏdeductionforsavingsactuallyincreasesavings?Youcanexplorethesubstitutioneffectﾏvs.theincomeeffect(・.e.・・JoeBobmightwanttomaintainacertainstandardoflivingﾐ  
 ・・ ﾐregardlessandnotsavemorethanthe$10,000).Soitreallyboilsdowntoempiricalﾏeconomics.Studiesareperhapsinconclusiveregardingwhetherchangesintaxlawcanﾏaffectindividualsavingsbehavior.(Wehadaconsumptiontax,sortof,intheearly80s,ﾏbutpersonalsavingsdidn'tgoup.Businessinvestmentmaybemoreresponsive.Ofﾏcourse,theremaybeotherfactors;empiricaleconomicsfacesproblemsincontrollingﾏvariables.)Ifpersonalsavingsarenotresponsivetotaxes,optimaltaxationtheorymightﾏsaytaxesonsavingsshouldbe・aised・・(Rememberoptimaltaxationtheoryтbesttotaxﾐ  
 $X­" ﾐinelasticitems,thosethathavenosubstituteandthusbehaviorwon'tbechangedbecauseﾏofthetax.)Whydopeoplesave?Ifyousaveforfixedtargets(like1/2millioninﾏpensions),thennottaxingsavingsmightactually・ecrease・thepercentageofincomeﾐ  
 ﾌ&"% ﾐsavedтoncethetargetishit,stopsaving,oryousavelessineachperiodtoreachyourﾏdesiredgoalbythetimeyouretire.ﾌﾓT@ﾜXｰ` ｸ  
hﾀpﾈ x‑ﾐ (#%ﾘ'0\*・森Tﾓﾌ・澣heotherissueinProblem2iswhetherChauncey'sbequestshouldbeinthetaxbase.ﾏItwouldseemsoundereitherstandard・f・ivingorabilityдoаayapproaches.ﾔ\_ﾔWhyﾐ  
 h+ｸ&\* ﾐshouldﾔ\_ﾔChaunceyﾔ\_ﾔbetreatedmorefavorablyfortaxpurposes,wholivesoffofinheritances,ﾏthanJoeBob,whoworkshardforhisliving?Buttheinfluenceoftrustaccountingmakesﾏonly$20,000taxable(discussedinmoredetaillater).Showshowearlydefinitionsofﾏ"income"borrowedfromtrustaccountingfailtoaddressthenormsunderlyingwhatﾏshouldbethepropertaxbase.ThegiftexclusionundertheCodewillbedealtwithinaﾏlaterchapter.ﾌﾌﾌﾌﾌ