TREASURY DEPARTMENT
Washington

(The following address by Randolph E. Paul, General Counsel for the Treasury, before the Chicago Chapter of Chartered Life Underwriters at the LaSalle Hotel, is scheduled for delivery at 1:45 P.M., Central War Time, Friday, October 15, 1943, and is for release at that time.)

SIMPLIFICATION OF OUR TAX LAWS

However much many of you in the audience today may disagree with specific items in my remarks I doubt if any of you will disagree with the importance and timeliness of my subject. Tax simplification has become the topic of the day. Columnists are prodigal with graphic phrases on the subject. Editorials frequently dispose of it with a few solemn, and often inaccurate, lines. Cartoonists like to give us the spectacle of the bewildered taxpayer, otherwise known as the Too Well Remembered Man, who is better remembered today than ever before. This unhappy creature is pictured as foregoing vacations to fill out intricate forms devised by sadistic experts hell-bent upon the humiliation of taxpayers. The latest medical books attribute nervous disorders to patients' bouts with the income tax collector.

I have a suspicion that the average taxpayer is in somewhat the same mood as Channing Pollock, who has said that he does not object to paying taxes, but that he does resent an attempt on the part of the Government to convert him into a combination of bookkeeper, accountant, lawyer and tax expert. Pollock wants to devote himself to writing. The average taxpayer may not want to write, but neither does he want his life to be frittered away by income tax detail.

Since there is misapprehension in some editorial quarters, let me say at the outset that we in the Treasury believe that many of the complaints against the complications of tax law are valid. We grant that the tax mechanism has become so hard to handle that it's time to stop for repairs. We even go so far as to admit that life has more interesting pursuits than filling out tax forms. Complications are not our stock in trade, as some people profess to think, -- at least, not our preferred stock in trade. We do not advocate an income tax law that passeth all understanding. We want a simple statute, if for no other reason -- than the selfish one that it makes life simpler for us. We like to go fishing too. But we also must realistically respect the vast difficulties we face. Simplicity cannot be pulled out of a hat by any white rabbit process. The problem must be understood before we can even begin to solve it.

The first point to have in mind about simplification is that it is not a new idea. In an opinion issued in 1918 Mr. Justice McKenna referred petulantly to the 1913 Act as one which "concerns the activities of men and intended, it might be supposed, to be without perplexities and readily solvable

by the off-hand conceptions of those to whom it was addressed." I am old enough to remember much tax discussion back in the Twenties. Even then things were in a bad way. By 1927 complaints about the complexity of the income tax reached a crescendo, and the Joint Committee on Internal Revenue Taxation undertook a careful consideration of how the income tax could best be simplified. Its report resulted in a rearrangement of the law in the 1928 Act, so that the ordinary taxpayer was better able to find at the beginning of the Act the material that interested him most. The committee reached the following conclusion:

> "It must be recognized that while a degree of simplification is possible, a simple income tax for complex business is not. The task is to simplify the law and the administration for all taxpayers so far as possible, without causing real hardship to those with complex sources of income and various business enterprises who cannot be taxed justly under a simple, elementary law."

The demand for simplification has not been restricted to the territorial limits of the United States. Back in 1915 the late Sir Josiah Stamp, an eminent British authority on revenue matters, was prompted to write: "There is the usual failure to see that modern life and modern commerce are so complex and diversified that to expect a tax form which shall read like a pill advertisement on the railway, and yet close down upon every case, is asking for the moon."

The same realistic note is to be observed in the famous report of the Colwyn Commission in England, which listened to many pleas for simplicity made by a great number of witnesses, some of them experts in dealing with income tax matters on behalf of the public. The Colwyn Commission found the suggestions made "generally vague and indefinite." "They were either unable to give us concrete or definite proposals, or, where they did make proposals, we found that to adopt them would be to do injustice to taxpayers whose peculiar circumstances would not have been recognized, or to expose the Revenue unnecessarily to the risk of loss. We have formed the opinion that in Income Tax matters simplicity is not the sole object to be aimed at, and that the price that would have to be paid for a simple Income Tax could not be justified."

I cannot leave the subject of simplification of British taxes without quoting a remark made by Mr. Justice Rowlatt, whose unhappy lot it has been to spend his days unravelling the revenue laws of the United Kingdom. In a case dealing with a section of the 1927 Finance Act the learned Justice expressed his exasperation in the following language:

> "That section in five pages of the 'Law Reports' edition of the statutes, makes piecemeal amendments of section 21 of the Finance Act, 1922, which make it perfectly unintelligible to the layman, and to any lawyer who has not made a prolonged study of it with all his law books at his elbow. It is a crying scandal that legislation by which the subject is taxed should appear in the

> Statute-book in that utterly unintelligible form. I am told by the Attorney-General--and rightly told, I am sure--that it is only in this form that the legislation can be carried through at all. Then all I have to say is that the price of getting this legislation through is that the people of this country are taxed by laws which they cannot possibly understand. This is the worst example that there has ever been upon the Statute-book."

I do not want you to think that I am in a defeatist mood about simplification. Far from it. But I am well aware, and I hope you too are well aware, that simplification is a complicated task. It is a task that cannot be easily or quickly accomplished. It is a problem which cannot be solved by airy generalities. It is a long term and full time assignment for all who are sincerely interested in the future of taxation. It is a job that will never be completely done. Yet it is a job that must be tackled.

The job had better be tackled with an understanding of the distinction between simplicity and simple language. This is an audience which can readily appreciate that distinction. You are all familiar with the famous insurance section of the estate tax statute, which was first enacted in 1918 and remained unchanged until the 1942 Act. The laconic five lines of this provision once seemed simple enough. There were no complicating amendments for more than twenty years. Yet the few words contained in this provision have furnished a remarkable example of what Professor Chafee has called "the disorderly conduct of words." At different times the apparently simple language of the insurance section has meant many things to many men. The one thing the language did not mean, according to regulations and court opinions, was what it seemed on its face to mean. The language, "taken out by the decedent upon his own life," did not refer to the person who applied for the policy and paid the first premium, since such a naive construction of the statute would have opened the floodgates to wholesale tax avoidance.

A scientific analysis of the problem of simplification requires that we inquire at the outset into the causes of complexity. I suggest that there are three primary causes. The first is the necessity for protecting the revenue. There are always taxpayers and tax specialists who are on the hunt for loopholes. Indeed, one court has said that tax avoidance is in the nature of mortals. I should be the last person to put blame upon anyone who attempts to minimize tax liability. The Supreme Court itself has hardly ever failed to render mandarin courtesy to the doctrine that "When the law draws a line, a case is on one side of it or the other", and if the case is on the safe side, it "is none the worse legally that a party has availed himself to the full of what the law permits." But I do insert in parenthesis that it is better at least for the uninitiated not to get too near the line, and I am sure that all of you will agree, particularly in time of war, to the necessity of insuring the end that "no one should be permitted to avoid his just share of the tax burden." The escaped burden is inevitably passed on to others.

If we are to prevent tax avoidance we must have provisions designed to that end. Such provisions, of necessity, are often complicated. They must be complicated because one dare not fire a shotgun into a crowd. They must be precise instruments which do their job of preventing avoidance without injuring innocent taxpayers. " * * * it is not enough to attain to a degree of precision which a person reading in good faith can understand; * * * it is necessary to attain if possible to a degree of precision which a person reading in bad faith cannot misunderstand."

An example in point is the personal holding company provisions. The 1937 tax investigation amply demonstrated the need of preventing the avoidance of tax by the use of incorporated pocketbooks. If you will look at the Code, you will find that 11 sections are devoted to this one item of avoidance prevention, each of which has required much administrative and judicial interpretation.

A perhaps more important cause of complication is the necessity, intensified when rates are high, of giving relief in exceptional cases. The 1942 Act beat all records in the quantity and scope of its relief provisions. Page after page is devoted to relief; 120, or more than half of the total 208 pages, are devoted to the cancellation of inequities. In addition, 42 pages are devoted to clarifications and definitions to enable more equitable and fair enforcement. This makes a total of 104 corrective sections out of a total of 173. In pages, this is nearly 78 percent of the Act, 162 pages out of 208.

To these causes of complexity there must be added another underlying cause. Income tax law begins with the statute, but it does not end there. It journeys on into interpretative regulations and many informal administrative rulings. Then the courts make their retail contribution to a wholesale statute. The Tax Court, the Court of Claims, the District Courts, the Circuit Courts of Appeal, and the Supreme Court, all add their quota of judge-made law. It must be remembered that the courts quite properly do not restrict themselves to the literal language of the statute. Words are not crystals; they have many meanings depending on the context. No matter how articulate a statute may be, there is always room for interpretation; the meaning of each sentence may be more than that of the separate words, as a melody is more than the notes of music. No degree of particularity can ever obviate recourse to the setting in which all statutory language appears and which all the words of the statute collectively create. To paraphrase former Chief Justice Hughes' remark about the Constitution: "We are under an income tax statute, but the statute is what the judges say it is."

There is another way of approaching the subject of simplification. We may divide complications into two types. Under the first classification one could put those provisions which affect large numbers of taxpayers. Under the other classification one might put provisions which affect only limited groups of taxpayers.

The necessity of simplifying provisions for the benefit of large numbers of taxpayers has increased in importance in the war years. In 1932 we had

slightly less than 2 million taxable individual returns. There will be about 40 million taxable returns for the year 1943. A reasonable number of complications may be handled in 2 million returns. To handle complications in 40 million returns is a horse of a different color. And while our tax system might safely, though not wisely, irritate 2 million of our citizens, it will run serious risks if it irritates twenty times that number.

In recognition of this grim fact the Treasury has made many suggestions in the last two years, some at the cost of reducing the revenue. For example, in 1941 we recommended the short form return to Congress. In 1942 we recommended the elimination of the earned income credit, not because we were out of sympathy with some differentiation in favor of earned income, but because the mis-named earned income credit in the existing law was not worth the complexity it involved. In 1942 we also recommended the elimination of the capital stock-declared value guessing contest. Recently, in his appearance before the Ways and Means Committee, the Secretary of the Treasury recommended the elimination of the victory tax. The Treasury had originally opposed this measure on the ground that it would unduly complicate the tax system. Now that chicken has come home to roost.

In his recent appearance before the Ways and Means Committee the Secretary of the Treasury also recommended the consolidation of the normal tax and the surtax into one tax, thus avoiding the necessity of separate calculation. Such a consolidation will not result in a windfall to the owners of partially tax exempt Government securities if we give the income from those securities special treatment by permitting a credit against the total tax computed by multiplying the income from such securities by the existing normal tax rate. Such a credit would have effect only with respect to the limited number of taxpayers owning such securities, and would free other taxpayers from the extra burden of two computations. It would, of course, entirely respect the exemption now enjoyed by the owners of partially exempt securities.

Another suggestion originating with Judge Vinson and recently made to the Ways and Means Committee was that withholding be put on a gross basis under a system which would enable taxpayers to understand instantly what percentage of their salaries was being withheld at the source. We also recommended to the Committee that collection at the source be made to apply on a graduated basis to the taxpayer's full liability rather than his partial liability under the first bracket. This recommendation, if accepted, will have the beneficial result of eliminating quarterly declarations for all persons who have salaries taxable at brackets above the first bracket rate and no other substantial source of income.

While most corporations are in a better position than most individuals to employ legal and accounting assistance in the preparation of their returns and the determination of their tax liability, many small corporations are in much the same position as the ordinary individual taxpayer. Undue complication is inexcusable even in the corporate field. In this connection I call to your

attention the fact that we now have five principal kinds of corporate taxes. We have (1) the ordinary normal and surtax, (2) the excess profits tax, (3) the declared value excess profits tax, (4) the capital stock tax, and (5) the personal holding company tax. The whole administrative machinery operates separately with respect to each tax. The result is much duplication and waste of manpower on the part of corporate executives and employees. Clearly the capital stock tax and the declared value excess profits taxes should be eliminated even at the cost of revenue. As a matter of fact, any loss in revenue could easily be regained, without any substantial redistribution of the corporate tax burden, by increasing the corporate income tax rates.

Turning to complications which affect only limited groups of taxpayers, everyone will readily admit that there is much work to be done. The so-called reorganization provisions are almost unbelievably complicated. Various trust provisions have resulted in a flood of litigation. The corporate relief provisions of the 1942 Act present a staggering administrative problem. The new powers of appointment provisions of the 1942 Act fall far short of solving the problems with which they courageously deal.

The whole problem of co-relation of the income, estate and gift taxes has had little realistic thinking for many years. We have called upon the outside tax bar to help us in the solution of this problem, and have appointed a committee to make a careful study of the subject. In the Treasury we are working upon all these, and many other, problems.

The problem of simplification is one of degree. Undoubtedly the popular demand for simplification has greatly increased in the last few years as our rates have mounted to new high levels and as our taxes have extended their reach to many more taxpayers. Without doubt the Current Tax Payment Act of 1942 has touched off the most recent demands for simplification. This Act, with its esoteric forgiveness and windfall provisions, has confounded confusion. With these provisions and the victory tax in the statute it has become impossible to prepare a reasonably simple tax form. Yet we must have such a form. The law must be simplified so that the average man of the street will not need to employ a lawyer or an accountant to compute his income tax liability.

Simplification is an intensely desirable objective, particularly in respect to individual taxes paid by the mass of the people. It is also desirable that provisions affecting smaller groups be untangled. But simplification is not the offhand job many people suppose it to be. To a degree it can be accomplished; the Treasury is giving more than lip service to the task. We hope we may have your help as we take each step on this uphill road.

But let us not delude ourselves. There can be no perfectly simple tax statute that he who runs may read. Let me correct myself; there can be such a statute. But you would be the first to protest if it were enacted. The price of too much simplicity would be too much injustice, and too much escape from tax by too many. The wise choice must be the greatest possible simplification consistent with the greatest equity to all taxpayers.

Many years ago the Chinese philosopher Mencius said, "I like fish, and I also like bears' paws, but if I cannot get both together I will let the fish go and take the bears' paws." Like history, philosophy sometimes repeats itself: in modern times the late Justice Holmes pointed out that for everything we have we give up something else, and urged that we balance advantages gained against other advantages lost, knowing what we are doing when we elect.

The issue of simplicity requires a choice in which the advantage we gain must be set against the advantage we lose. We should know what we are doing when we elect. We should know that ultimate simplicity and perfect equity are incompatible. Somewhere in the wilderness there is a middle road between these two extremes.

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