Tax Policy, Rational Actors, and Other Myths

*By Leo P. Martinez**

> [T]ax law is always a compromise among the views of powerful individuals and groups.[1]

I. INTRODUCTION

Tax Policy is frustrating. I have always been weighed down by the elusive and, as yet, unproven presumption that there is an overarching grand design that sees to a rational and uniform approach to tax policy.[2] My naiveté has roots. My pre-law background is in physics and math, so I am, by dint of experience, a reductionist—hence, my attraction to the simple, coherent, and elegant explanation of complex phenomena. In making this admission, I am painfully aware of Professor Daniel Shaviro's observation that "[t]he temptation to over-predict and over-simplify may reflect a misguided craving for the intellectual prestige of 'hard' science, more than a rational choice about how best to put science to work for us."[3] This may explain the lack of prediction in this piece.

My naiveté has limits. I recognize that tax policy is a mess. It is incoherent, full of contradiction, and works at cross purposes to itself. It is ill-used, misunderstood, and ignored. The real problem is what to do about the mess.

---

* Professor of Law, University of California, Hastings College of the Law. Special thanks to Professor Lily Kahng of Seattle University School of Law, Professor Marjorie Kornhauser of the Sandra Day O'Connor College of Law, Arizona State University, and to my colleagues Vic Amar, David Faigman, David Jung, Calvin Massey, Reuel Schiller, and William K.S. Wang for their insights into and inspiration for the creation of this article. The author gratefully acknowledges the diligent and able research assistance of Brandon Yu, Jennifer Nejad, and Meghan Covert.

1. JOSEPH A. PECHMAN, FEDERAL TAX POLICY 38 (5th ed. 1987).

2. My apologies to the many who have articulated the bases of a grand design. *E.g.*, Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1 (2006) (noting that traditional grounds for evaluating tax policy are efficiency, equity, and administrability); Anthony C. Infanti, *Tax Equity*, 55 BUFF. L. REV. 1191 (2008) (referring to the triad of tax policy concerns: efficiency, equity, and administrability).

3. Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 122–23 (1990).

One of the leading treatises on tax policy recognizes that "the prevalence of government may reflect the presence of political and social ideologies which depart from the premises of consumer choice and decentralized decision making."[4] It recognizes that in a real world there may very well be no strong connection between the system of taxation and the expectations of the populace. The subtext of the message is that tax policy may be devoid of systematic design.

Certainly, popular and political perspectives, along with a healthy dose of self-interest, have always been hallmarks of modern tax policy. In this article, I demonstrate that tax policy is a largely mythical concept, more akin to the Holy Grail than to anything else. Tax policy more nearly describes an ideal than it describes a normative principle. I conclude that self-interest, irrationality, and ineptitude explain the vicissitudes of tax policy in the modern world.

In making my observations, I again take pains to freely acknowledge that I am biased in favor of coherence and rationality.[5] While I realize that my bias conflicts with Justice Cardozo's celebrated dictum to the effect that "[t]hose who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred,"[6] my own view is that justice and just results are better attained if logic and symmetry play a more prominent role.

II. TAX POLICY AND THE FAILINGS OF DEMOCRACY

Stated baldly, the democratic process is not up to the task of dealing with tax policy. Legislatures, the executive branch, and the courts have been demonstrably unable to cope competently with tax policy. This wide-sweeping incompetence is not limited to the three branches of government. The citizenry, in its role as collective sovereign—to borrow Professor Christian Fritz's characterization[7]—has also shown its

4. RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 5 (4th ed. 1984).

5. A mild disagreement with this thesis appears in a finely written essay. James P. Spica, *Tax Rationality and the Independence of Irrelevant Alternatives*, 12 AKRON TAX J. 205 (1996) (noting that while coherence is desirable, it may not be sufficient to trump other desirable values). *But see* Stephanie Hoffer, *Hobgoblin of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 UTAH L. REV. 317 (2006) (containing a related discussion on the judicially created duty of consistency).

6. Jacob & Youngs v. Kent, 129 N.E. 889, 891 (N.Y. 1921).

7. CHRISTIAN G. FRITZ, AMERICAN SOVEREIGNS 7 (2008).

inability to deal in a rational way with the concept of tax policy. I address these failings in turn.

A. The Congress and State Legislatures

Neither the United States Congress nor state legislatures have been able to cope with tax policy in a meaningfully coherent way. A few examples serve to illustrate the point.

Congress' inability or unwillingness to craft a coherent tax policy is easily shown by examining the Internal Revenue Code (Code) broadly and by examining selected Code provisions.[8] To begin, tax policy is plagued by push-me/pull-you issues that act to defy changes to the status quo. These issues cut across geographical lines, temporal lines, and income level lines.

For example, the personal residence interest deduction is considered sacrosanct, and it tends to disproportionately benefit taxpayers with high incomes—those with high income can afford large mortgages and their high marginal tax rates maximize the effect of the personal residence interest deduction.[9] It is predictable that a reduction of any sort would cause consternation by the real estate and financial services industries.[10] Similarly, elimination of the charitable deduction would create consternation.[11] I do not quarrel with either deduction. The

8. An unflattering portrait of Congress is painted in a recent article. Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159 (2006) (suggesting that Congress is as much at fault as the various special interest groups).

9. The Code allows a deduction from gross income for "qualified residence interest." I.R.C. § 163(h)(3) (2000 & West Supp. 2008). The greater a taxpayer's income, the greater income tax rates she pays. Thus, deductions which reduce income are more valuable to those with high incomes. Edmund L. Andrews, *Bush Names 2 Ex-Senators to Consider Tax Changes*, N.Y. TIMES, Jan. 9, 2005, at A17.

10. Martin A. Sullivan, *The Economics of the American Dream*, 106 TAX NOTES 407, 407 (2005); Andrews, *supra* note 9, at A17.

11. Broadly, the Code provides a deduction for charitable contributions made to qualifying recipients. I.R.C. § 170(a), (c) (2000 & West Supp. 2008). As one commentator has noted:

> The charitable deduction enables people to donate as much of their assets as they like for charitable purposes without paying a tax. While some choose to contribute to broad public goals, the law does not require it. In recent years, charitable status has been recognized for organizations with purposes as idiosyncratic as promoting excellence in quilting and educating the public about Huey military aircraft.

Ray D. Madoff, *Dog Eat Your Taxes?*, N.Y. TIMES, July 9, 2008, at A23; *see also* McCaffery & Cohen, *supra* note 8, at 1195; Warren Vieth, *Commission Begins Review of the Tax Code*, L.A. TIMES, Feb. 17, 2005, at A18.

difficulty is that the intense lobbying that surrounds even the hint of altering existing deductions has the tendency to stifle informed debate.[12]

An example of the disparate geographical reach and inconsistency of the Code is provided by the deduction for the payment of state income and property taxes under Section 164.[13] The deduction avoids a kind of "double taxation" by allowing taxpayers to reduce their gross income by the amount of state taxes paid. The difficulty of this approach from the perspective of a coherent federal tax policy is that there arises a geographical asymmetry resulting from two primary sources.

First, high value real estate tends to be concentrated on either coast and in large urban areas.[14] To the extent the deduction is a benefit to those who incur high property taxes, the benefit is disproportionately allocated away from the residences of rural states, most of which are located away from an ocean.

Second, the geographical asymmetry can be attributed to the different mechanisms by which states raise revenue. To the extent that a state raises revenue through a state income tax, the citizens can take advantage of the deduction. In a nod to symmetry, the Code allows residents of states that depend on a sales taxation for revenue to elect a deduction of general state sales taxes in lieu of a deduction for state income taxes.[15] This election forces residents of states that choose to raise revenue by means of both income taxes and sales taxes to lose the benefit of either the payment of income taxes or sales taxes—either of which can be significant.[16]

12. Ryan Donmoyer, *Bush Tax Plan Must Create Losers, Rostenkowski Says*, BLOOMBERG, Feb. 16, 2005, http://www.bloomberg.com/apps/news?pid=10000087&sid=aNIiMib1phWI&refer=top_world_news (noting that Eugene Steuerle, a senior fellow at the Urban Institute, suggests that dealing with large deficits creates a similar problem).

13. I.R.C. § 164 (2000 & West Supp. 2008). This is not to suggest that there is anything inherently suspect with this so-called double taxation.

14. Laura Sherman, *America's Most Expensive Cities*, FORBES, July 24, 2008, http://www.forbes.com/realestate/2008/07/23/cities-america-expensive-forbeslife-cx-ls-0724expensive_us.html. According to Sherman, the ten most expensive cities are, in order: New York City, NY; Los Angeles, CA; Miami, FL; Honolulu, HI; San Francisco, CA; Chicago, IL; White Plains, NY; Houston, TX; Boston, MA; and Washington DC. *Id.* *See also* Matt Woolsey, *Most Expensive ZIP Codes*, FORBES, Sept. 13, 2007, http://www.forbes.com/realestate/2007/09/12/zip-expensive-list-forbeslife-cx_07zip_mw_0913realestate.html. According to Woolsey, the ten most expensive ZIP codes (based on median home sales price between July 2006 and June 2007) are: Alpine, NJ; Miami Beach, FL; Rancho Santa Fe, CA; Glenbrook, NV; Amagansett, NY; Water Mill, NY; Santa Barbara, CA; Purchase, NY; Ross, CA; and Chilmark, MA. Woolsey also notes that "[t]he list is dominated by ZIPs in the nation's coastal states." *Id.*

15. I.R.C. § 164(b)(5).

16. A prior version of the Code allowed a deduction for all state taxes paid. *See* Jeffrey S. Kinsler, *Circuit-Specific Application of the Internal Revenue Code: An Unconstitutional Tax*, 81

To be sure, the picture is vastly more complicated than the one I paint. For example, one observation is that the taxpayers who are denied the benefit of the Section 164 deduction realize a benefit in increased spending for local services—more police and fire protection, better schools, and better infrastructure.[17] That is, the sting of the geographic asymmetry is lessened by the receipt of benefits.

A few scholars have offered the thought that tax policy does not necessarily consider the whole picture in terms of the effects of tax legislation; it is not comprehensive in its scope. For example, Professor Christine A. Klein suggested some years ago that the capital gain rollover rule embodied in former Code Section 1034 had a significant and unintended effect.[18] That is, Section 1034 discouraged investment in older residences because it provided that the capital gain on the sale of a personal residence was deferred only on the subsequent purchase of a home of equal or greater value.[19] Accordingly, taxpayers desiring to defer capital gains taxes on the sale of a personal residence were economically encouraged by the Code to buy more expensive housing if they desired to move. After extensive review of the effects of Section 1034, Professor Klein's conclusion was that it not only encouraged overinvestment in housing but that it also had the disadvantage of increasing the stock of suburban housing at the expense of reducing farmland and investment in urban housing.[20] The ostensibly laudable goal of the Section 1034 rollover rule of removing an impediment to travel by the elderly had a tremendously large, and wholly unintended, negative effect.[21]

DENV. U. L. REV. 113 (2003) (discussing the geographical inconsistency of the Code). The Code allows the Internal Revenue Service to create tables that obviate the tracking of purchases by keying the sales tax deduction to income levels. I.R.C. § 164(b)(5)(H).

17. Brian Galle, *Federal Fairness to State Taxpayers: Irrationality, Unfunded Mandates, and the "SALT" Deduction*, 106 MICH. L. REV. 805, 813 (2008).

18. Christine A. Klein, *A Requiem for the Rollover Rule: Capital Gains, Farmland Loss, and the Law of Unintended Consequences*, 55 WASH. & LEE L. REV. 403, 406 (1998).

19. I.R.C. § 1034 (1994) (repealed 1997).

20. Klein, *supra* note 18, at 465.

21. *Id*. The Section 1034 non-recognition provision is not the only perverse aspect of tax policy regarding homes. The personal residence interest deduction is skewed to benefit high income taxpayers because the value of a deduction is greater for those with high marginal tax rates. David Leonhardt, *Untangling Housing and Taxes*, N.Y. TIMES, Apr. 2, 2008, at C4. Higher income taxpayers are also more likely to itemize deductions, and so the personal residence interest deduction is not "wasted" as it is in the case of low income taxpayers who might not itemize deductions. *Id*.

More recently, Professor Leandra Lederman made a related observation.[22] Based on her ambitious study of the Internal Revenue Code, she has observed that the federal income tax system subsidizes entrepreneurs.[23] In the abstract, this is not a surprising or necessarily undesirable conclusion. It makes sense to encourage business risk and to reward entrepreneurs for bold initiatives. Professor Lederman, however, concludes that the system provides an *implicit* incentive to investment in business activities.[24] Her surmise is that the apparently worthy policy goal is not the result of intention but of accident.[25]

A more insidious form of "accident" is the subject of commentary by Professors Beverly I. Moran and William Whitford.[26] Professors Moran and Whitford conclude that African-Americans are systematically short-changed by the Internal Revenue Code for a number of reasons. These include African-Americans' reduced ability to take advantage of the Code's incentives for capital investment, the fact that African-Americans are less likely to be the recipients of tax-favored gifts or inheritances, and the fact that African-Americans, who own homes that are generally less costly than the average, do not exploit the personal residence interest deduction or the deduction of real estate taxes paid to the same extent as their Caucasian counterparts.[27] If this disparate impact of the Code is intentional, it is reprehensible. If this disparate impact is accidental, it is a tragedy of misjudgment. In either event, it makes little sense, and the "tax policy" involved cannot be described as coherent.[28]

Additionally, tax policy does not necessarily age well. What made sense many years ago might not make sense today. For example, the Alternative Minimum Tax (AMT) may have made sense when it was

22. Leandra Lederman, *The Entrepreneurship Effect: An Accidental Externality in the Federal Income Tax*, 65 OHIO ST. L.J. 1401 (2004).

23. *Id.* at 1407–09.

24. *Id*. at 1409.

25. *Id.* at 1477.

26. Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751 (1996).

27. *Id*. at 799–800; *cf.* Patricia A. Cain, *Heterosexual Privilege and the Internal Revenue Code*, 34 U.S.F. L. REV. 465 (2000) (noting various ways in which the Internal Revenue Code disadvantages homosexuals). Professor David Brennan has neatly surveyed recent related literature. David Brennan, *Race and Equality Across the Law School Curriculum*, 54 J. LEGAL EDUC. 336, 337 n.5 (2004).

28. I write this with an awareness that, while I agree with Professors Moran and Whitford, this view is not universally followed. Professor Anthony C. Infanti has neatly summarized the debate. Infanti, *supra* note 2, at 1216–21.

enacted in 1986.[29] The AMT was aimed at wealthy taxpayers who were perceived to be avoiding an inordinate amount of tax liability through deductions and tax shelters.[30] However, because the tax is not indexed to inflation, it has snared many middle-class taxpayers in its net while allowing many of its originally targeted high-income taxpayers to escape. In the year 2001, the AMT affected only about one percent of taxpayers, or about one million individuals.[31] One estimate suggests that the number of taxpayers that will be caught within the AMT trap will be forty-six million by 2014.[32] Surely, there will not be forty-six million "wealthy" tax-avoiding taxpayers in 2014. Unless the AMT is modified in significant respect, those forty-six million taxpayers will be subject to a tax that originally was aimed at only a few. This represents two tax policy failures: the first is the original failure to craft a tax provision that would age gracefully, and the second is the inability of the Congress to address the resulting problem.

Individual aspects of the Internal Revenue Code present interesting policy dilemmas. My favorite example is the tax treatment of illicit behavior. Code Section 162(c) limits the deductibility of bribes and kickbacks.[33] Section 280E denies deductions if a taxpayer's trade or business consists of dealing illegally in controlled substances.[34] Considered alone or in the abstract, these provisions seem to make sense. However, the provisions beg the question of why other types of illegal behavior escape similar treatment. Presumably, if a taxpayer engages in murder-for-hire, his or her expenses (the cost of target practice, bullets, travel, and disguises) are otherwise fully deductible against the fully taxable income from such pursuit. If a murder-for-hire

---

29. DANIEL J. LATHROPE, THE ALTERNATIVE MINIMUM TAX § 1-13 (Supp. 2008) (describing the advent of a comprehensive AMT).

30. Donmoyer, *supra* note 12.

31. CONG. BUDGET OFF., REVENUE AND TAX POLICY BRIEF NO. 4, THE ALTERNATIVE MINIMUM TAX (2004).

32. Allen Kenney, *Former Commissioners Say It's Time to Scrap AMT*, 103 TAX NOTES 1466 (2004).

33. The Code denies a deduction for three different kinds of illicit payments. These are (1) illegal payments to government officials or employees, (2) other illegal payments, and (3) kickback, rebates, and bribes under Medicare or Medicaid. I.R.C. § 162(c) (2000 & West Supp. 2008).

34. The Code's statement in this regard is an unusually succinct, single-sentence which disallows the trade or business expense deduction if the trade or business "consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted." I.R.C. § 280E (2000 & West Supp. 2008).

specialist avoids the payment of bribes or kickbacks, expenses are not otherwise treated any differently than in any other trade or business.

Continuing this theme, income from drug dealing and murder-for-hire is clearly subject to federal taxation.[35] Does this mean the United States is a stakeholder in such illicit behavior? Because of the limitation on deductions related to illegal drug dealing, is the government profiting even more from the illicit behavior of drug dealing? Such are the quandaries presented by even the most prosaic provisions of the Internal Revenue Code.

A final example of the perversity of tax policy is the Earned Income Tax Credit (EITC). The EITC, described in Section 32, provides a tax credit to taxpayers whose income does not exceed a threshold amount.[36] Even in my abridged version of the Code, Section 32 runs four and one-half pages of single-spaced print.[37] Professor Dorothy Brown observes that the Internal Revenue Service publication that is intended to assist taxpayer understanding of the EITC "is over *fifty* pages long with six separate worksheets."[38] The irony of the EITC is that while it is extraordinarily complex, it is aimed at a segment of the population that, on balance, is likely to be less educated than the general populace.[39] Moreover, while the EITC serves to encourage taxpayers to join the workforce and generate income so that tax benefits can be realized, its substantial flaw is that it provides no benefit to those who are unable to find employment.[40] This class of taxpayers generally will include children and the disabled—those who are most often in need.[41]

The Code's internal inconsistency and its fostering of contradictory policies has occurred incrementally over time. Even so, this tendency to contradiction can be seen at particular points when the contrast between self-interest and political behavior is especially stark. On June 1, 2004,

35. *See* Daniel C. Richman & William J. Stuntz, *Al Capone's Revenge: An Essay on the Political Economy of Pretextual Prosecution*, 105 COLUM. L. REV. 583 (2005) (discussing how Al Capone was brought down for failure to pay income taxes, not his other crimes).

36. I.R.C. § 32 (2000 & West Supp. 2008), *amended by* Pub. L. No. 110-246, § 4002(b)(1)(B), 122 Stat. 1857, *and* Heroes Earnings Assistance & Relief Tax Act, Pub. L. No. 110-245, § 102(a), 122 Stat. 1624.

37. SELECTED FEDERAL TAXATION STATUTES AND REGULATIONS § 32, at 35–40 (Daniel J. Lathrope ed., 2008).

38. Dorothy A. Brown, *Race and Class Matters in Tax Policy*, 107 COLUM. L. REV. 790, 793 (2007).

39. *Id.*

40. CHARLES WHEELAN, NAKED ECONOMICS: UNDRESSING THE DISMAL SCIENCE 41–42 (2002).

41. *Id*.

President George W. Bush and 258 members of Congress signed a "no new taxes" pledge. The pledge aimed to restrict government spending by opposing any increase in marginal income tax rates as well as prohibiting any removal of tax deductions without an accompanying reduction in marginal tax rates.[42] Rationally speaking, signers of the pledge should have supported all tax and spending cuts. However, according to voting records analyzed by William Gale and Brennan Kelly, while congressional signers of the pledge voted for permanent tax cuts over the last several years, they have also overwhelmingly voted for permanent spending increases during a period of declining revenue.[43] Such contradictory behavior is yet more evidence of the underlying irrationality inherent in democratically determined tax policy—at a minimum, it illustrates that political motivations might trump wealth-maximization principles.

As these few examples show, Congress has more than amply demonstrated ineptitude in tax matters.[44]

State legislatures, for their part, have fared no better, and state systems of taxation are not immune from inconsistency and incoherency. For example, in *Guinn v. Legislature of Nevada*,[45] decided on September 17, 2003, the Nevada Supreme Court was called on to resolve a legislatively created constitutional crisis. The case involved a conflict of state constitutional provisions. On one hand, the Nevada Constitution provides that revenue and tax bills must pass by two-thirds majority of the State Senate and the State Assembly.[46] On the other hand, the Nevada Constitution requires both a balanced budget and full funding of education.[47] *Guinn* involved circumstances under which the Nevada Legislature was able to pass, by simple majority, a balanced budget to fund education, but the associated revenue bill required to balance the budget could not muster the requisite two-thirds vote.[48] The salient point is that the crisis was precipitated by the

42. William G. Gale and Brennan Kelly, *The 'No New Taxes' Pledge*, 104 TAX NOTES 197, 197 (2004).

43. *Id.*

44. As amusing as I find this exercise, a comprehensive exegesis of the perversity of the Code would easily be a multi-volume work. Thus, I use only a few examples to make my point.

45. Guinn v. Legislature of Nevada, 76 P.3d 22 (Nev. 2003).

46. NEV. CONST. art. IV, § 18 cl. 2; *Guinn*, 76 P.3d at 25–26.

47. *Guinn*, 76 P.3d at 28–29.

48. The resolution of the impasse does not bear on this paper. The impasse was resolved when the Nevada Supreme Court held that the "procedure" of the supermajority requirement would have to yield to the "substance" of the balanced budget requirement. *Guinn*, 76 P.3d at 33. More specifically, the Nevada Supreme Court in *Guinn* drew "a distinction between substantive

inability of the legislative body to tackle directly a significant aspect of tax policy. To understate the situation, the time, money, heartache, and heartburn involved in resolving the dilemma could have been more productively spent. At its best, the legislative process is cumbersome and indirect.[49] One is tempted to conclude that legislatures, at either the State or Federal level, may not be the best place to cure the problem of an inconsistent tax policy.

B. The Executive Branch

In the same way, the executive branch has been singularly unable to exert effective leadership in dealing with tax policy. The first President Bush was forced by the economy to stand by and let Congress raise taxes to reduce potential budget deficits, effectively recanting his signature pledge, "[r]ead my lips," a part of his resolute position against raising taxes.[50]

In President George Herbert Walker Bush's case, the needed tax increase was implemented. Thus, it cannot be said his leadership failed in that sense. On the other hand, the recantation of his no taxes pledge essentially doomed his chances for a second term. In a way, his experience is the most damaging because it may well have convinced many in the executive branch (the lesson cannot be lost on legislators) that any kind of support for taxes, however well justified, is fatal—the "third rail" of American politics in the view of many.[51]

Still, the laboratory of politics provides ample opportunity to observe the practical effects of advocating tax increases. Despite the suggestion above that President George Herbert Walker Bush's experience might dissuade state executives from entering the arena of taxation, at least

---

requirements of the government and procedural requirements of the legislative process." Robert Ward Shaw, *The States, Balanced Budgets, and Fundamental Shifts in Federalism*, 82 N.C. L. REV. 1195, 1226 (2004).

49. CHARLES WHEELAN, *supra* note 40, at 64; *see also* Bernard (Bob) Shapiro, Lindy Paul, Hon. Bill Archer, Pamela Olson, Woodworth Memorial Lecture: The Role of Tax Policy in the Development of Tax Legislation (May 15, 2005), *in* 32 OHIO N. U. L. REV. 1 (2006) (describing the tax legislative process in Congress); Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1 (1990) (broad and comprehensive analysis of the legislative process).

50. Ann Devroy, *Domestic Perils Sink President in Last Campaign*, WASH. POST, Nov. 4, 1992, at A21; Charles Krauthammer, *Trapped by Campaign Rhetoric*, WASH. POST, Feb. 26, 1993, at A23; Paul Taylor, *Bush's Vivid Self-Portrait—Caring, Practical Everyman Depicted*, WASH. POST, Aug. 19, 1988, at A1; George Will, *Deficit Goes Up, Bush Goes Down*, SEATTLE POST-INTELLIGENCER, Oct. 14, 1990, at D2.

51. Grover Norquist, *Alabamans Protect the GOP Brand*, THE AM. ENTERPRISE, Dec. 2003, at 48.

two governors have subsequently been willing to actively support tax increases. The spectacular failure of both governors to achieve their goals is instructive as a lesson in tax policy, in politics, and in democracy.

In September 2003, Alabama Governor Bob Riley, a Republican, attempted to pass a state constitutional amendment that would have raised state taxes by $1.2 billion.[52] After years in business, Governor Riley had served three terms in the House of Representatives as one of Newt Gingrich's lieutenants.[53] As a member of the House, Governor Riley was once cited as its most conservative member; nonetheless, as Governor of Alabama, he was persuaded that a revenue increase was needed to close a nearly $700 million state budget shortfall as well as to shore up Alabama's 50th rank in per pupil school spending.[54]

Governor Riley did not stint in his support of the tax increase. He attempted to act because he believed Alabama taxpayers would support an increase to make the Alabama tax system more progressive, to pay for schools, and to balance the budget.[55] Relying on his impeccable conservative credentials to support the tax, Governor Riley claimed that "Jesus of Nazareth would want this tax hike" and that it was un-Christian to forgo support for public schools.[56]

While Governor Riley could have anticipated some opposition to his proposal, it is a safe bet that he was taken aback by the reaction. The tenor of the resulting firestorm is captured by a telephone call made to a political columnist by the head of the Christian Coalition of Alabama, who claimed that "the very same people who took the [Ten Commandments] out of the judicial building are now trying to raise your taxes."[57] The President of Americans for Tax Reform was less kind; he saw Governor Riley as an example to be avoided and presumably deserving of some unnamed dire fate if he insisted on "steal[ing] a billion dollars from [the] people."[58]

52. John Mercurio, *George W. Bush Giveth, Bob Riley Taketh Away*, CNN.COM, Sept. 9, 2003, http://www.cnn.com/2003/ALLPOLITICS/09/09/mgrind.day.riley.

53. Josh Patashnik, *In the Jungle: A Political Perspective—Why the GOP Isn't Serious About Budget Cuts*, HARVARD INDEP., Mar. 3, 2005, *available at* http://www.harvardindependent.com/news/2005/03/03/Forum/In.The.Jungle.A.Political.Perspective-885385.shtml.

54. *Id.*

55. Norquist, *supra* note 51, at 48.

56. *Id*.; Patashnik, *supra* note 53.

57. Bill Schneider, *Voters Crush Alabama Tax Hike Proposal*, CNN.COM, Sept. 15, 2003, http://edition.cnn.com/2003/ALLPOLITICS/09/15/ip.pol.opinion.alabama.voters.

58. Mercurio, *supra* note 52.

With this opposition, Alabama voters rejected Governor Riley's proposal by greater than a two-to-one margin.[59] Not surprisingly, Governor Riley spent a significant time before his reelection bid in 2006 tending to the wreckage caused by his tax proposal.[60] The Governor discovered that there is a heavy price to pay by pursuing the cause of fiscal responsibility—however well-justified it might be.[61]

Undaunted but perhaps informed by his colleague's experience in Alabama, in early 2005 Indiana's Republican Governor Mitch Daniels attempted to pass a one year, one percentage point tax hike for those earning over $100,000 a year (the top six percent in Indiana).[62] Governor Daniels was an executive with Eli Lilly before joining the Office of Management and Budget, where he earned the nickname "the Blade" for the budget cuts he sought during his tenure.[63] Governor Daniels was dealing with a serious state fiscal crisis. For the 2005 fiscal year, Indiana faced a $645 million budget deficit.[64] Adding to its woes, Indiana had exhausted whatever accounting tricks were available to meet the state constitutional balanced budget requirement.[65]

Like Governor Riley, Governor Daniels tried to take the offensive. First, he announced his proposal to increase taxes in his inaugural gubernatorial address, in which he asked "the most fortunate among us, those citizens earning over $100,000 per year," to shoulder the burden coupled with a pledge that the increase would last but one year.[66] He followed up with an editorial in a major Indiana newspaper in which he tried to make the case for a tax increase in a methodical and logical way.[67] In his editorial, he cited the budget shortfall in the face of a poor economy, stated that discretionary spending had been reduced to the extent possible, cited the inefficacy of further accounting gimmicks with the balanced budget requirement, stated that the tax would affect only one in twenty taxpayers, and vowed that the tax increase was

59. Schneider, *supra* note 57.

60. Mercurio, *supra* note 52.

61. Schneider, *supra* note 57.

62. Mitch Daniels, Op-Ed., *To Balance the Budget, State Must Balance the Burden*, INDIANAPOLIS STAR, Feb. 20, 2005, at 1E.

63. *Id*.; *see also Epiphany on the Road to Indiana***,** N.Y. TIMES, Feb. 24, 2005, at A22.

64. Dan Gilgoff, *Hoosier Hysteria over Taxes: Back Home in Indiana, Has the Governor Betrayed Conservatives?*, U.S. NEWS & WORLD REP., Mar. 7, 2005, at 24, 24.

65. *Id.*

66. Mitchell E. Daniels, Jr., Indiana Governor, State of the State Address (Jan. 18, 2005), *available at* http://www.in.gov/gov/2530.htm.

67. Daniels, *supra* note 62, at 1E.

temporary.[68] He also invoked his constitutional duty to the fiscal health of the state and, by inference, appealed to the patriotic duty of Indiana taxpayers.[69]

Like his Alabama colleague, Governor Daniels quickly incurred the wrath of the President of Americans for Tax Reform, who accused the Governor of "papering over Indiana's problems" by focusing on raising taxes instead of reducing spending.[70] His reputation as "the Blade" did not insulate him from the wrath of his former supporters. Perhaps unsurprisingly, Governor Daniels' proposal received little support in the Indiana House of Representatives.[71] Undaunted by this lack of support, Governor Daniels then sought to raise revenue by increasing the cigarette tax.[72] While his effort to increase the cigarette tax failed initially, a cigarette tax was ultimately enacted into law.[73] Perhaps mindful that he is up for reelection in 2008, Governor Daniels has more recently attempted to limit the rates of increase in property taxation.[74] This proposal seems to be facing a positive prospect before the Indiana legislature.[75]

Both Governor Riley and Governor Daniels are Republicans. Neither of them could be described as advocates of tax increases. Indeed, both had been at the forefront of anti-tax fervor. With the governors' backgrounds, there are some who see their respective dilemmas as deliciously ironic.[76] However, both face real difficulties that have no easy solution. Ultimately, they, like President George H.W. Bush, find themselves painted in a corner by what has been characterized as the "Republican Brand"—the no new taxes pledge.[77]

68. *Id.* Like Governor Riley, Governor Daniels also invoked the memory of President Reagan, who was forced to ask for a tax increase in his first year as governor of California. *Id.*

69. *Id*.

70. *Id.*

71. Mary Beth Schneider & Kevin Corcoran, *Budget Balancing Act: 1 Year Tax Increase*, INDIANAPOLIS STAR, Jan. 19, 2005, at A1.

72. Fred Barnes, *Hoosier Jump Shot*, WALL ST. J., Sept. 15, 2007, at A8.

73. *Highlights of Past State of the State Addresses by Gov. Mitch Daniels*, INDIANAPOLIS STAR, Jan. 15, 2008, at A4.

74. Amy Merrick, *Politics & Economics: Property-Tax Frustration Builds—States, Cities Revise Strategy as Homeowners Protest Rising Levies*, WALL ST. J., Dec. 18, 2007, at A6. Governor Daniels' property tax plan is presented in detail on the Governor's website at http://www.in.gov/gov/3105.htm.

75. Crystal Garcia, *Property Tax 'Game' About to Get Started*, TRIBUNE-STAR, Mar. 9, 2008, http://www.tribstar.com/local/local_story_068214915.html.

76. Patashnik, *supra* note 53.

77. Norquist, *supra* note 51.

C. The Judiciary

The judiciary is particularly ill-suited to take on the burden of dealing with tax policy because it faces a number of structural impediments in its ability to craft policy. First, the primary role of courts is to reconcile tax legislation with constitutional prescriptions. In that role, the courts can affect tax policy only by invalidating tax legislation on constitutional grounds.[78] In the tax context, this is seldom done. Moreover, when invalidating legislation on constitutional grounds, the judicial function "is not subject to 'correction' by the ordinary legislative process."[79] The formulation of a rational tax policy requires an ability to react that is not so constrained.

Second, the courts can affect tax legislation in their role as referees by giving their interpretation to tax legislation that is ambiguous. However, such a limited role allows the judiciary to do little more than react to legislation.

It follows that courts have traditionally favored a large degree of judicial deference with regard to law-making. Beyond the foregoing, the philosophy is explained by the view that "even improvident decisions will eventually be rectified by the democratic process and that judicial intervention is generally unwarranted no matter how unwisely [a court] might think a political branch has acted."[80] There is a certain fallacy in the model that relies on election of lawmakers to cure defects in the tax system, and this idea has always struck me as devoid of a connection with the real world. Voting is more complex than the single issue of taxation. Not all voters vote on the basis of inequities in the tax system. Voters rarely prioritize candidate choice based on a critical analysis of a candidate's tax policy.[81]

The Supreme Court's reticence to intrude into tax matters seems to extend even to its deference to the United States Tax Court. As Justice

78. *See generally* JOHN HART ELY, DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW 4 (1980) (discussing judicial review generally and the power it affords the courts).

79. *Id.*

80. Nordlinger v. Hahn, 505 U.S. 1, 17–18 (1992) (quoting Vance v. Bradley, 440 U.S. 93, 97 (1979)).

81. In each of several polls conducted on the issue, the relative unimportance of taxes is clear. Several polls suggest that Americans are more likely to view various other issues such as the economy, Iraq, and social security as "extremely important." *See e.g.*, CNN/Opinion Research Corporation Poll (June 26–29, 2008), *available at* http://www.pollingreport.com/prioriti.htm. *See also* Time Poll conducted by Abt SRBI (June 18–25, 2008), *available at* http://www.pollingreport.com/prioriti.htm; CBS News Poll (July 31–Aug. 5, 2008), *available at* http://www.pollingreport.com/prioriti.htm

Jackson once famously explained, the Tax Court might be "a more competent and steady influence toward a systematic body of tax law than [the Supreme Court's] sporadic omnipotence in a field beset with invisible boomerangs."[82]

Even without this deference to lawmaking and to specialty courts, the courts have always expressed a reluctance to invalidate tax legislation. As I have noted elsewhere, the Supreme Court protects the government's power to tax by setting extremely high thresholds for striking down a tax as unconstitutional and by narrowly construing any claims that its power of taxation is limited in any significant way.[83] Still, it forms no principled basis for justifying a greater judicial role in formulating tax policy.

A number of scholars have gently suggested a wider role for the judiciary. Professor Daniel Shaviro's vague encouragement to courts to adopt a broad theory of judicial interpretation strikes me as inadequate to the task.[84] I have no quarrel with a broad judicial power to interpret, and I do not question the courts' ability, in Judge Calabresi's view, to allow judges to "shape our law, at least at the level of making conditional rules that can be revised by legislatures."[85] The problem remains that the judiciary performs a reactive role. Even with Judge Calabresi's expansive view of judicial power, no court can actually craft or be instrumental in crafting tax policy. This is reminiscent of Professor Kirk Stark's criticism of the initiative and referendum processes to the effect that each is done without an analytic framework.[86] Courts lack the requisite analytic framework to formulate tax policy, and there is simply not enough play in the joints to allow a court to perform this function. For this last reason and for the reasons articulated above, the inevitable conclusion is that the judiciary is not the cause and cannot be a solution to the mess of tax policy.

82. Arrowsmith v. Commissioner, 344 U.S. 6, 12 (1952) (Jackson, J., dissenting).

83. Leo P. Martinez, *To Lay and Collect Taxes: The Constitutional Case for Progressive Taxation*, 18 YALE L. & POL'Y REV. 111, 134 (1999); *see also* Eduardo Penalver, *Regulatory Takings*, 104 COLUM. L. REV. 2182, 2198 (2004).

84. Shaviro, *supra* note 3, at 113–14.

85. GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 92–93 (1982).

86. Kirk J. Stark, *The Right to Vote on Taxes*, 96 NW. U.L. Rev. 191, 192 (2001) (citing GEOFFREY BRENNAN & JAMES M. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION 189 (1980)).

D. The People as Collective Sovereign

The public seems largely ignorant of how taxes work. Decisions are made by voters without a full appreciation of what is at stake. Existing commentary on the public's perceptions of tax systems demonstrate that the popular concept of taxation diverges significantly from reality. It is nothing short of surprising to observe the extent to which intelligent people misperceive taxes and the system of taxation.[87] Professors Steven M. Sheffrin and Marjorie Kornhauser have stated flatly at different times that public opinion is ill-informed on tax matters.[88] The ignorance is observable at the retail level and at the wholesale level.

At the retail level, in one prominent study, Michael Roberts and Peggy Hite discovered that, though the public may believe current taxation to be unfair, when asked to specify what rate structure *would* be fair based on income, respondents tended to choose rates similar to those actually in place.[89] This is a remarkable outcome. The public seems only to understand taxes enough to know that they do not like them, and the public might not understand the purpose or the rationale of the tax system, yet the public is somehow able to intuit an equitable rate structure.

An example of the irrationality underlying United States tax policy at the wholesale level emerges when one examines which states benefit the greatest from federal spending and which states benefit the least. In a *New York Times* editorial, Daniel H. Pink described states that received less than a dollar back from the federal government for every tax dollar their citizens contributed in taxes as "givers" (net losers) and states who pocketed more than a dollar for every tax dollar their citizens sent to Washington as "takers" (net winners).[90]

Pink based his observations on a 2004 Special Report published by the Tax Foundation.[91] According to the report, for fiscal year 2003,

87. Marvin A. Chirelstein, *The Flat Tax Proposal – Will Voters Understand the Issues?*, 2 GREEN BAG 2d 147, 147–48 (1999).

88. Marjorie Kornhauser, *Educating Ourselves Towards a Progressive (and Happier) Tax*, 45 B.C. L. REV. 1399, 1403–04 (2004) (noting that few taxpayers understand the concept of progressive taxation); Steven M. Sheffrin, *What Does the Public Believe About Tax Fairness?*, 46 NAT'L. TAX J. 301, 303 (1993) (pointing out examples of popular misconceptions about particular aspects of taxation); *see also* JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE GREAT DEBATE OVER TAX REFORM 61–62 (2d ed. 2000).

89. Michael L. Roberts & Peggy Hite, *Progressive Taxation, Fairness, and Compliance*, 16 J.L. & POL'Y 27, 32 (1994).

90. Daniel H. Pink, *Givers and Takers*, N.Y. TIMES, Jan. 30, 2004, at A25.

91. *Id.*

New Mexico was the biggest "taker" in terms of federal outlays received relative to federal tax burden. For each $1.00 New Mexico's taxpayers paid to Uncle Sam, they received a windfall of $1.99 in return in federal expenditures.[92] Other federally favored states included Alaska ($1.89), Mississippi ($1.83), and West Virginia ($1.82).[93] Conversely, the biggest "giver" states were New Jersey, who was rewarded a paltry $.57 cents for every $1.00, followed by New Hampshire ($.64), Connecticut ($.65), and Minnesota ($.70).[94]

Paradoxically, of the top ten states benefiting from generous federal expenditures, nine of them are "red" states who supported President George W. Bush in the 2004 election.[95] Those states generally favored low taxes and limited government spending. By contrast, eight out of the top ten states whose tax burdens exceeded federal outlays are the

92. Sumeet Sagoo, *Tax Foundation Special Report No. 132: Federal Tax Burdens and Expenditures by State: Which States Gain Most from Federal Fiscal Operations?*, TAX FOUND., Dec. 2004, at 3; *see also* Curtis S. Dubay, *Tax Foundation Special Report No. 139: Federal Tax Burdens and Expenditures by State: Which States Gain Most from Federal Fiscal Operations?*, TAX FOUND., Mar. 2006, at 3.

93. Sagoo, *supra* note 92, at 3.

94. *Id.*

95. The table below summarizes the results from the cited works. Dubay, *supra* note 92, at 3; Sagoo, *supra* note 92, at 3.

Top Ten Beneficiary States (by ratio of federal spending received to federal tax burden)					
Sagoo's 2004 Article			Dubay's 2006 Article		
State		"Red"/"Blue" State	State		"Red"/"Blue" State
North Dakota	$1.75	Red	North Dakota	$1.73	Red
Montana	$1.80	Red	Montana	$1.58	Red
New Mexico	$1.99	Red	New Mexico	$2.00	Red
Kentucky	$1.52	Red	South Dakota	$1.49	Red
Mississippi	$1.83	Red	Mississippi	$1.77	Red
Alabama	$1.69	Red	Alabama	$1.71	Red
West Virginia	$1.82	Red	West Virginia	$1.83	Red
Virginia	$1.58	Red	Virginia	$1.66	Red
Alaska	$1.89	Red	Alaska	$1.87	Red
Hawaii	$1.50	Blue	Hawaii	$1.60	Blue

"blue" states that historically have supported increased federal spending.[96]

In the aggregate, seventeen states ostensibly serve as benefactors to thirty-one states who are beneficiaries of federal largesse (two states, Oregon and Florida, have a perfect balance of taxes paid and spending received). With the exception of Colorado, Georgia, Indiana, Nevada, and Texas, the remaining twelve "giver" states are blue (among which are California, New York, and Illinois). Conversely, of the thirty-one beneficiary states, only seven (Hawaii, New Mexico, Pennsylvania, Maryland, Rhode Island, Vermont, and Maine) are blue. The net effect is a tax system that geographically redistributes wealth predominantly from the middle class of blue states, who support higher taxes and increased spending, to the middle class of red states, who fiercely oppose expansive tax policy and liberal government expenditures.

Another example of taxpayers' irrationality with respect to tax policy is found in California. In 1978, the voters of California used the initiative process—acting in their capacity as sovereign, to use Professor Christian G. Fritz's term again—to pass Proposition 13, the poster child for the shortcomings of direct democracy.[97] Proposition 13 amended the California Constitution and had the effect of limiting property taxes in several ways.[98] First, it fixed the valuation of property

96. The table below summarizes the results from the cited works. Dubay, *supra* note 92, at 3; Sagoo, *supra* note 92, at 3.

Top Ten Benefactor States (by ratio of federal spending received to federal tax burden)					
Sagoo's 2004 Article			Dubay's 2006 Article		
State		"Red"/"Blue" State	State		"Red"/"Blue" State
Minnesota	$.70	Blue	Minnesota	$.69	Blue
California	$.78	Blue	California	$.79	Blue
Nevada	$.70	Red	Nevada	$.73	Red
Colorado	$.80	Red	Colorado	$.79	Red
Illinois	$.73	Blue	Illinois	$.73	Blue
New York	$.80	Blue	New York	$.79	Blue
New Hampshire	$.64	Blue	New Hampshire	$.67	Blue
Massachusetts	$.78	Blue	Massachusetts	$.77	Blue
Delaware	$.82	Blue	Connecticut	$.66	Blue
New Jersey	$.57	Blue	New Jersey	$.55	Blue

97. *See* K.K. DuVivier, *Ballot Initiatives and Referenda: Out of the Bottle: The Genie of Direct Democracy*, 70 ALB. L. REV. 1045 (2007) (providing a crisp description of direct democracy); Stark, *supra* note 86, at 192 (describing Proposition 13 as a "fiscal earthquake").

98. CAL. CONST. art. XIIIA.

to its original purchase price. Second, it fixed property tax rates at one percent of valuation. Finally, it imposed a two percent cap on annual increases in assessed valuation.

Because the value of California property has increased over time at a rate that far exceeded the two percent cap, a large disparity in property taxes paid by homeowner quickly resulted. For example, if I purchased my home in 1981 for $200,000, it was subject to a property tax of $2,000. This $2,000 was subject to an annual increase of two percent. By the year 2005, the value of my home might very well be on the order of $1 million. If, in 2005, my neighbor purchased the house adjoining mine for its fair market value of $1 million, that house would be subject to an annual property tax of $10,000. In my case, even with an annual property tax increase of two percent, my property taxes would not have even doubled in the same twenty-four year period. Thus, even though my neighbor and I own essentially identical homes and consume essentially identical amounts in fire, police, and other infrastructure expenditures, my neighbor pays nearly three times the property taxes that I pay.

This disparity resulted in the celebrated *Nordlinger v. Hahn*.[99] In *Nordlinger*, Stephanie Nordlinger, a California property owner, challenged the Proposition 13 scheme.[100] Her complaint was that she paid approximately four times the property taxes that her neighbor in a similar house paid.[101] Her neighbor's lower property taxes were based on an acquisition cost that was one-fourth of her purchase price.[102]

The U.S. Supreme Court upheld the constitutionality of Proposition 13 in an opinion by Justice Blackmun.[103] Justice Stevens' dissent criticized the inequities created by Proposition 13.[104] He pointed out, for example, that there were instances in which some homeowners paid as much as seventeen times as much in property taxes compared to those with similar property.[105] Not surprisingly, he characterized the system as irrational, concluding that "the severe inequities created by Proposition 13 [were] arbitrary and unreasonable and [did] not

99. Nordlinger v. Hahn, 505 U.S. 1 (1992).
100. *Id.* at 7–8.
101. *Id.* at 7.
102. *Id.*
103. *Id.* at 18.
104. *Id.* at 28–30 (Stevens, J., dissenting).
105. *Id*. at 29.

rationally further a legitimate state interest."[106] He was the lone dissenter.

The *Nordlinger* case neatly makes two of my points. First, the Supreme Court demonstrates that poor tax policy is not within the Court's ability to police. Second, the people, in their sovereign capacity, are poor crafters of tax policy. Taxpayers are plagued with cognitive biases and misperceptions that cloud the ability of economic theory to predict their behavior.[107] The real point is that taxpayers do not always make good—read: rational—choices about their tax behavior.[108]

Perhaps validating Professor Daniel Shaviro's observation that wealth-maximization principles are insufficient to explain taxpayer behavior,[109] it is evident that pocket-book concerns do not explain the anti-tax sentiment in the gaining red states as it does not explain the tolerance for taxes in the losing blue states. Paul Krugman has made essentially the same observation citing the divergence of economic interest and political views.[110]

Similarly inexplicable is Californians' seemingly blind allegiance to Proposition 13, despite the possibility of fifty-to-one disparities in property tax obligations. It does not take particular insight to guess what Justice Stevens would think about Proposition 13 today some thirteen years after still more appreciation of California real estate. Justice Stevens would not be alone in his criticism of Proposition 13. No less than Warren Buffett himself, as the informal financial advisor to now Governor Arnold Schwarzenegger, criticized Proposition 13, noting that the system made no sense.[111] Yet despite the disparities created by Proposition 13, the gross imbalance in property taxes for similar properties, the high prices created in part by the lack of turnover in properties, and the decline in school funding, there is little support for

106. *Id.* at 30.

107. Galle, *supra* note 17, at 808–09 (providing an excellent analysis of the overall problem of tax policy failings in the context of a particular Code provision); *see also* Reuven S. Avi-Yonah, *The Report of the President's Advisory Panel on Federal Tax Reform: A Critical Assessment and a Proposal*, 59 SMU L. REV. 551, 561 (2006) (discussing the proposition that individuals do not always behave rationally).

108. Galle, *supra* note 17, at 815–18. Professor Brian Galle makes the point that in some cases, the "choice" that depends on geography is really not available to most taxpayers. *Id*. at 814.

109. Shaviro, *supra* note 3, at 8.

110. PAUL KRUGMAN, FUZZY MATH: THE ESSENTIAL GUIDE TO THE BUSH TAX PLAN 15 (2001).

111. Tim Rutten, *Unwelcome Light from Buffett's Star*, L.A. TIMES, Aug. 16, 2003, at E1.

Warren Buffett's view. In a state where neighbors consume the same in police and fire protection while paying vastly different property taxes, the hue and cry is to preserve Proposition 13 and not abandon it.[112]

If even Warren Buffett's considerable financial acumen is insufficient to persuade California taxpayers that Proposition 13 makes no sense, more is at play. Some hint is perhaps given by Governor Schwarzenegger's quip that "[t]he public doesn't care about figures."[113] Ultimately, the public must care about figures if the republic is to survive.

III. WHAT TO DO

The true difficulty in dealing with tax policy is deciding what to do. Tax policy is a complex calculus that involves the role of government and social welfare. Reliance on economic theory is not necessarily the answer. Economics is simply an analytical tool that does not necessarily provide solutions to difficult problems.[114] Reliance on a free market to sort things out will not necessarily achieve an equitable outcome.[115] Indeed, almost twenty years ago, Professor Daniel Shaviro suggested that the extant explanations for the course of tax policy did not account for "how self-interested political behavior apart from wealth maximization shapes legislative outcomes."[116]

President George W. Bush took a well-worn path by naming a Tax Advisory Panel to create a simpler and fairer tax system that recognizes the importance of homeownership and charity.[117] The bipartisan panel held hearings and reported back to the President at the end of July 2005.[118] Those with long memories should be reminded of the use of

112. *Id*.

113. Paul Krugman, *Conan the Deceiver*, N.Y. TIMES, Aug. 22, 2003, at A23.

114. *See* WHEELAN, *supra* note 40, at 41 (stating that "economics does not give us a 'right answer'—only an analytical framework for thinking about important questions").

115. *Id*. at 51.

116. Shaviro, *supra* note 3, at 8.

117. *See generally* Exec. Order. No. 13369, 70 Fed. Reg. 2323 (Jan. 7, 2005), *available at* http://www.taxreformpanel.gov/executive-order.shtml. The consequent report was issued in late 2005 and it proposed two alternatives: a simplified income tax and a consumption-like tax. THE PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, & PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM (2005); *see also* Samuel C. Thompson, Jr., *Federal Tax Reform and Reducing the Bush Deficit by $800 Billion*, 110 TAX NOTES 1486 (2006). Neither proposal has been acted on. *Id.*

118. Thompson, *supra* note 117, at 1486.

panels to attempt to resolve other knotty problems, including base closures and sentencing guidelines.[119]

Whether it was possible that the Panel could have accomplished anything meaningful is open to debate. One Panel member announced early on that the Panel's goal was not consensus but the creation of alternatives.[120] Others criticized the Panel's approach that limited the consideration of the deduction for personal residence interest and for charitable contributions.[121] It is perhaps a sad comment on democracy if our elected officials cannot deal with a knotty problem without passing the responsibility to others in the guise of a "panel." It is not surprising that the Panel's recommendations have gone nowhere.[122]

Some academics, including me, have suggested that an informed electorate is the answer.[123] However, it is not entirely clear whether an informed electorate, while hugely useful to rational tax policy, is a realistic goal.[124] In his book *The Tipping Point*, Malcolm Gladwell posits that small stimuli can have huge effects.[125] In particular, he notes that the populace is susceptible to subtle influences of which those being influenced may not be aware.[126] An informal observation might be that the whole body of consumer marketing is based on this premise. This is all the more dangerous because irrationality can be selective and those who are so inclined can prey on this tendency.[127] A public,

---

119. While I make light of this approach, it is not completely irrational to attempt to take thorny decisions out of the hands of partisans. *See* Shaviro, *supra* note 3, at 114–15.

120. *Id*.

121. Edmund L. Andrews, *Bush Names 2 Ex-Senators To Consider Tax Changes*, N.Y. TIMES, Jan. 9, 2005, at A17.

122. David Leonhardt, *Untangling Housing and Taxes*, N.Y. TIMES, Apr. 2, 2008, at C1; *see also* Thompson, *supra* note 117, at 1486; Avi-Yonah, *supra* note 107, at 574–86 (setting forth a comprehensive analysis of the Panel's report); Christopher H. Hanna, *Tax Theories and Tax Reform*, 59 SMU L. Rev. 435 (2006) (discussing the twin recommendations of the panel, a modified version of the current income tax system and a partial consumption tax system).

123. *E.g.*, Kornhauser, *supra* note 88, at 1401; Leo P. Martinez, *Tax Legislation and Democratic Discourse: The Rhetoric of Revenue and Politics*, 4 NEV. L.J. 510, 517 (2004); Nancy C. Staudt, *The Hidden Costs of the Progressivity Debate*, 50 VAND. L. REV. 919, 990 (1997).

124. Shaviro, *supra* note 3, at 112 (expressing pessimism about the possibility of an informed electorate).

125. MALCOLM GLADWELL, THE TIPPING POINT (2000).

126. *Id*. at 74–80 (citing subtle mannerisms by a news anchor on a national election). Professor Marjorie Kornhauser suggests that cognitive psychology theory can inform popular attitudes about tax and tax policy. Kornhauser, *supra* note 88, at 1404; *see also* Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861 (1994). Professor McCaffrey observes that framing how an issue is presented can have dramatic effects. *Id*. at 1915.

127. BRYAN CAPLAN, THE MYTH OF THE RATIONAL VOTER: WHY DEMOCRACIES CHOOSE

under-informed on tax issues, may not understand what policies a lawmaker stands for, or worse, may not care. A discussion of more than superficial tax policy is seldom at the forefront of the political debate. Thus, tax policy is susceptible to being influenced by ideology despite intellectual dishonesty.[128] Moreover, economist Charles Wheelan notes that organized interests can skew legislation because the masses of those who are not interested have so little at stake.[129] In addition, a single vote counts for so little that a taxpayer feels justified in paying little heed to voting responsibly.[130] It is not surprising, then, that the Code is so littered with tax policy inconsistencies.

Governor Daniels, a disciple of Karl Rove, apparently took Gladwell's and Kornhauser's suggestions to heart when he attempted to shape the debate on his tax increase. Yet, despite his attempts, he failed to sway either public opinion or the Indiana House of Representatives. His experience, certainly, was a triumph of taxpayer/voter incompetence over process and informed decision-making. It also demonstrated that the theory of cognitive psychology is far from working its magic in this arena.

It is easy to let a certain amount of pessimism contaminate the realistic hope for rational tax policy. Dr. Peter C. Whybrow argues in his book, *American Mania: When More is Not Enough*, that the rise of a selfish kind of individualism can be attributed to a weakened social fabric.[131] Whybrow believes that in the earlier days of the republic the American disposition to self-interest was tempered by a sense of community; over time, this sense of community has diminished with a consequent rise in self-interest.[132] Ironically, some have observed that the federal tax policy that encouraged the shopping center boom also contributed to the demise of the positive social effects of neighborhood restaurants and shops.[133]

BAD POLICIES 2–3 (2007).

128. KRUGMAN, *supra* note 110, at 8.

129. WHEELAN, *supra* note 40, at 137–38. Professor Bryan Caplan posits that it is possible for a small number of the electorate who are keenly interested in a particular outcome to hold sway where the remaining members of the electorate simply don't care about an outcome and simply vote randomly. CAPLAN, supra note 127, at 6–9.

130. CAPLAN, supra note 127, at 6–9.

131. PETER C. WHYBROW, AMERICAN MANIA: WHEN MORE IS NOT ENOUGH 36 (2005).

132. *Id.* at 36-37.

133. ROBERT D. PUTNAM, BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY 288 (2000).

IV. CONCLUSION

It is possible that the various inconsistencies in the Code may mask a grand design so that they even out in the wash as a sort of rough justice. Indeed, assuming a random distribution of inefficiencies and inconsistencies, this idea may even be demonstrable. Still, rough justice is a poor substitute for a rational, uniformly applied system of taxation. It is difficult not to feel pessimistic about the prospects of an informed electorate capable of initiating meaningful change. Marjorie Kornhauser's eloquent turn of phrase, "[t]ax debates have always been a forum in which Americans explore the nature of their government,"[134] seems a good note to strike. In a country founded upon the outspoken voices of colonial opposition to burdensome taxes, it seems that the modern populace has forgotten its historical involvement and has allowed incoherent tax policy to flourish.

Former Internal Revenue Service Commissioner Mortimer M. Caplin, in an essay titled *The Tax Lawyer's Role in the Way the American Tax System Works*, has suggested that the proper functioning of the tax system depends on the responsible involvement of tax lawyers and tax accountants.[135] My judgment is that Commissioner Caplin's aim is too narrow. While I agree with his premise, the responsibility he discusses belongs to all and is not the narrow province of lawyers and accountants. Perhaps the broad conclusion is that the systematic irrationality and incoherence of tax policy has the deleterious effect of damaging compliance with the tax system. Irrationality and incoherence, in the words of one commentator, combine to "[hobble] goodwill towards Congress (or the legislative process, etc.) as a motivation for compliance."[136] We can do better.

134. Marjorie E. Kornhauser, *Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America*, 50 BUFF. L. REV. 819, 829 (2002).

135. Mortimer M. Caplin, *The Tax Lawyer's Role in the Way the American Tax System Works*, 106 TAX NOTES 697, 700 (2005).

136. Spica, *supra* note 5, at 221.