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# Our Tax System—Time for Reappraisal

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THE DIVERSITY of your program today is a good indication of the complexity of our tax structure and of the many conflicting interests that must be resolved in measuring and dividing available sources of tax revenue. You will hear talks on several of the important recent changes in the Federal income tax laws, changes brought about through court decisions, as in the taxation of estates and trusts, legislative changes, and changes in administrative attitude, such as the introduction of the new guidelines for testing depreciation allowances. While the changes made this year in the Federal tax system may seem at first glance to be unusually broad in their impact, they are only surface indications of the ever-sharpening conflicts among the special interests of different taxpayer groups and between taxpayers themselves and the tax-collecting bodies of the Government.

## CONFLICTS OF TAX LAWS

The history of the Revenue Act of 1962 is a good example of the impact of the social, political, and economic forces that tend to make our tax laws complex because of the difficulty of resolving their conflicts. On April 20, 1961 when the President sent his Tax Message to Congress he sought stimulation for a lagging economy through the investment tax credit. This was intended as an aid to business and it probably was a great shock to those who proposed it when they learned that many businessmen would prefer not to receive this particular gift but would rather shop for another one instead. In the same message the President sought payment for the gift through a series of changes that would close what he regarded as loopholes. Perhaps the public was surprised by the controversy that followed. You should not have been. It was evident at the time that the package requested was unusually full of items that would be regarded by many taxpayers as unnecessary and unfair. Congress did not give the President some of what he asked, such as withholding on dividends and interest, and some of his proposals were changed drastically. The result is more of an undistinguished compromise than a great victory,

or a great improvement. There is good reason to question whether the watered-down investment credit actually will be worth all of the trouble. The Revenue Act of 1962 was an object lesson, however, in the difficulty of achieving major tax change by removing benefits enjoyed by powerful taxpayer groups.

The conflicts in the Federal tax system are only part of the problem reflected in today's program. You will hear talks also on problems in state and local taxation, many of which stem from the inability of our various governments to agree as to their appropriate share of the tax money that is available.

All of these conflicts cause complexities. They are complexities to which we tax people have become accustomed and do not resist, perhaps as much as we should. Some of these complexities may even give us a comfortable feeling of vital importance because of our ability to interpret them. But there is good reason to question whether this feeling is justified. There is increasing evidence that taxpayers are becoming more restive under their tax burden. Certainly it would be too much to expect them to adopt the attitude of philosophical detachment and intellectual interest that is typical of the tax specialist intrigued with his own work.

The question we should ask ourselves before entering into this varied program is whether it is sufficient to keep up with what has happened recently and take a look and a guess at what may happen next year and the year after that. Is it not time to take inventory of the problems of the tax world and make a really concerted effort to do something about them?

### SERIOUSNESS OF TAX BURDEN

There is little question today of the seriousness of the tax burden. Where some years ago there was disagreement as to the impact of our high tax rates, depending to some extent on whether the commentator was responsive to business, labor, or political groups, there is surprising unanimity today on the need for a change. Donald Rogers summarized this well in the Herald Tribune on October 26 when he said:

A strange alliance is developing between big business and the Kennedy Administration, apparently for the purpose of lobbying for and spreading sentiment for a tax cut early in 1963.

When we have the United States Business Council on one hand and the Federal Government's economic advisers on the other seeking the same ends, certainly the rest of us should do something more than look on as interested observers. As Per Jacobsson, Head of the International Monetary Fund warned earlier this week, current high rates of taxation are a dangerous drag on business. This was repeated by Dr. Walter W. Heller in a recent article in which he said:

It now seems clear that one of the chief reasons for the sluggish behavior of our economy over the past five years or so is the persistent drag exerted by our present Federal tax system.

While high tax rates are operating as a business depressant their uneven impact has a further depressing effect because of the resulting vital importance to business of the unproductive activity of tailoring business decisions to tax-saving devices. It has been said that the Government is a 50 per cent partner in business. Certainly the partnership is not always a welcome one. Many capable business people spend much of their productive energy in tailoring their otherwise useful plans to tax-saving considerations.

## COMPLEXITIES

Although the amount of tax that must be paid by business and individual taxpayers is enough in itself to inhibit business activity, the all-encompassing complexities of the tax laws tend to intensify the businessman's sense of frustration. When the burden is heavy, as it is, and he does not even understand it clearly, his annoyance is multiplied. The laws have become so complex that many changes are not understood by the congressmen who enact them, except for the relative handful that serve actively on the House Ways and Means Committee and the Senate Finance Committee. Even we tax advisers have difficulty in keeping up with the vast amount of published material that comes to us each day.

Just to illustrate what has happened, compare the bulk of the present Federal income tax regulations with the final version of regulations 118, which interpreted the 1939 Code. Regulations 118 is three quarters of an inch thick and weighs seventeen ounces. The current regulations are two inches thick and weigh forty-four ounces and we know already that additional regulations are on the way.

The trend in Federal tax legislation and regulation has been

away from broad principle and in the direction of detailed rules intended to cover every conceivable contingency. This is partly to close loopholes devised by taxpayers, but a great deal of it is to delineate carefully the impact of legal loopholes (or special benefits) that have been created by Congress. Consider, for example, the body of regulations, rules, and decisions that have been built around something seemingly as simple as the medical expense deduction. Certainly an added burden to the person who becomes ill is the necessity of getting a tax adviser to tell him what his status is for Federal income tax purposes.

The developments this year probably have reached a new high in adding complexity. The new section 274, which provides for disallowance of certain entertainment and travel expenses, establishes several pages of new rules. Despite its specificity, it also introduces new subjective concepts that should give tax lawyers and the courts good exercise for years to come. No one really knows right now what is meant by entertainment expense that is "directly related to" or "associated with the active conduct of a trade or business," or when such expense "directly precedes or follows a substantial or bona fide business discussion." When is a traveling expense "lavish or extravagant under the circumstances" and when is an entertainment facility used "primarily for the furtherance of the taxpayer's business"? These are relatively simple examples of some of the new complexities. Others, such as the provisions primarily affecting foreign income, are much worse.

### INEQUITIES

The complexity of the Internal Revenue Code is only one of its frustrations. Many taxpayers are becoming more and more concerned with its inequities. There was little of this concern when high rates were first introduced in the late thirties and early forties. As it becomes more evident that prospects for rate reduction are not good and as taxpayers become more aware of the impact of the inequities in the law, they seem to become more and more dissatisfied with it. Although the screws have been tightened on some and others have been given relief through special benefits, such as the package of retirement, sick pay, and group insurance benefits available to employees, many taxpayers are not satisfied that relief from high rates is being distributed fairly and evenly.

## EVASION AND TAXPAYER INTEGRITY

You are all aware of the increasing attention the Internal Revenue Service has been giving to problems of tax evasion and the related problems of responsibility on the part of its employees and professional tax advisers. This was the subject of a talk that the Commissioner of Internal Revenue made before this group on May 9, 1962. Similar talks have been made by the Commissioner and others at meetings of tax-oriented people throughout the country. In fact, there has been so much discussion of the responsibilities of the tax adviser that the casual observer could not be blamed for misjudging its implications and being led to a false conclusion that the observance of ethical standards by lawyers and certified public accountants leaves much to be desired.

It would be very convenient if the whole problem could be solved by having the tax practitioner meet his responsibilities so resolutely and with such an unwavering enthusiasm to seek the best solutions to tax problems in the interest of all concerned that he would create an aura of fairness and reasonableness in the operation of the tax system sufficient to make it acceptable to those who are now rebelling against it. This approach would have the tax adviser reach out for a responsibility to make the tax laws work. It has validity, but it fails to recognize that he bears only a part of the burden of a system that is creating irresponsibility largely through its frustrations and inequities.

If our tax system is not working as perfectly as its creators and administrators would expect, a great deal of the blame can be laid to the grotesque law they have created and to overly competitive administration of that law in the past.

If we can agree that the burden of our tax system has become too heavy and that its unevenness and complexities have made taxpayers more and more sensitive, it may be that we are approaching a time of crisis, a time when the public will lose confidence in our self-assessment system if something is not done. This is not the sort of crisis that is likely to produce public hysteria, such as the world-wide political crisis that we now have in the Cuban situation, but a much quieter one that may not be recognized if we do nothing about it.

We have an opportunity today to do something about at least the Federal part of our tax burden that we have not had for many years. The opportunity is here because the seriousness of the burden is recognized by key government officials who honestly want to do

something about it. The President and his economic advisers clearly have called for a change. In this part of their program they seem to be fairly well aligned and in agreement with many important business leaders and their economic advisers. It is no secret either that those who make tax policy in the Treasury Department are very active right now in seeking ways to stimulate individual and business productivity through tax relief and to modify the harshness of some of the inequities of the law. This is a time of crisis because the opportunity is here to do something constructive if we will reach out for it.

It is not enough for people like us to be intellectually aware of the problem. What is needed is that we convert this awareness to a sense of urgency and a desire to take action. Each one of us should conduct his own search and analysis of the ways in which the tax structure might be improved and should express his views through the organizations with which he works and in personal letters to key members of Congress—the members of tax-writing committees—as well as to his own representatives. The task of tax reform is too full of political problems to expect that it will succeed unless there is organized activity in support of it. Certainly if this activity is not generated by those of us who know the problem, we cannot expect that others will accept the task that we have rejected.

