

THE ULTIMATE LOOPHOLE -
SPEND YOUR OWN MONEY

An Address by

Walter B. Wriston

Chairman

Citicorp

before

44th International Conference
of the

Financial Executives Institute

at

New Orleans, La.

October 20, 1975

Any of you who have observed with sorrow the disappearance of the American handyman have had either to learn some of his skills, or watch many of the mechanical devices in and around your homes break down. In acquiring handyman skills, you come to realize that a badly designed machine can never be fixed even by an expert at tinkering. Something more radical is required--redesign. This principle applies to many patchwork legislative solutions to social and economic problems which have been pasted together over the years.

The ultimate insult used to be to say something looked as if it had been designed by a committee. To the extent

that we can use the word designed, our tax laws actually fit that description. They were patched together by a multitude of committees over many years. All too often changes were made without reference to what existed before. Since the beginning of time, no tax structure has ever won the plaudits of the citizens, but there are few instances in history where all shades of political opinion have agreed unanimously that our tax laws are unfair, unclear, indeed, beyond understanding. It is literally true that no one in the world knows for sure what the tax law means. No policeman can read you your rights.

It is a maxim of cryptology that what one man can devise, another can unravel. This principle keeps armies of tax lawyers and accountants employed, but adds nothing to our national productivity. The distortions in our society caused by the quirks of the law beggar the imagination: companies that have lost money may be more valuable than others which make money. People with equal incomes pay unequal taxes. Often the heaviest burden falls on the working man or woman.

The blue-collar worker who has struggled hard to support his family, educate his children, and save his money suffers. His is the only group in our

society that gets a plethora of kind words from Congress, but laws which catch him in a double bind. Inflation pushes him into higher tax brackets while cutting deep into his purchasing power. His savings melt under the heat of inflation, while the interest on his proposed mortgage rises beyond his reach. Meanwhile Congress increases the payments to the non-worker, so that subsidies of the idle rise to meet the shrinking rewards of thrift and industry.

Now we can fairly charge, as did our forebears in the Declaration of Independence, that taxes are "imposed without our consent." Today, again, we have taxation without representation,

because it is impossible to have your point of view fairly represented in a matter so complex that no one understands it. This lack of understanding is not limited to the ordinary person trying to pay his tax in accordance with what someone tells him the law requires. It is a pervasive malaise extending to our representatives in the Congress who vote the laws. At a closed hearing on the tax bill last spring, several Senators complained that they did not understand for what they were being asked to vote. The Chairman of the Senate Finance Committee is reported to have said: "If every man insists on knowing what he's voting for before he votes, we're not going to get

a bill reported out by Monday." Monday clearly had priority over clarity.

The Constitution says that Congress is to provide for the "general welfare." Instead Congress pays more attention to special interests. Hundreds of bills are introduced to amend some part of the tax code. Many of the bills seek to benefit some sector of our society which has persuaded a Congressman that it needs help. Change is then effected by amending a section of the law, often referring to another section which itself refers to still another. A recent "simple" amendment to the tax reduction bill was "read by title." The title consisted of one sentence containing 69 words. Nestled among them

was a key phrase "and for other purposes," which meant anything with which Congress chose to fill what came to be called "the Easter basket."

No Congressman, no lawyer, no accountant can tell the taxpayer his rights with any certainty. No one even bothers to try to make a case that the present laws are equitable. Any law which cannot be understood is, by definition, an assault on democracy. Whenever a legislator, hard-pressed for a headline, needs a little free publicity, he or she announces in a tone of outrage one or another of the legitimate consequences of the law. The results are often so bizarre that each new announcement merely

reinforces the public awareness that the Congress has legislated a ripoff.

Each year one of the hallowed rites of spring is a legislator peering earnestly out of the television screen and bewailing the fact that some people pay no income tax. What they say is true. In 1973, for example, the IRS said there were seven persons with incomes in excess of a million dollars who paid no federal income tax. Yet no one can assert that they did not obey the law. They did no more than their Congress mandated. Obviously such a result makes no sense, and I do not think anyone should go tax free. The fault, however, is not with those who pay no taxes but with those

who turned taxation into a puzzle. You can be sure that some IRS officer built a government career auditing the returns of these non-taxpayers. A law which produces this result is obviously wrong. In place of holding up these few wealthy people to obloquy, the legislators should examine their own conscience in writing a law so complex that they did not know what they were doing. That is the very essence of legislative irresponsibility. Their acts lessen respect for all law and are disruptive of our society.

Since no one believes the present laws are fair, it is worthwhile inquiring how we got into this mess. An economist, Adam Smith, writing in the year our nation

was founded laid down basic principles. Taxes should be "certain, and not arbitrary . . . clear and plain to the contributor, and to every other person." Today taxes are uncertain, arbitrary and unclear; common sense has been stood on its head. We have arrived at our present absurd position because the original purpose of taxes as defined by Article I of the Constitution has been forgotten or ignored. The Constitution gave power to Congress "to lay and collect taxes" in order "to pay the debts and provide for the common defense and general welfare."

No mention is made in the Constitution in any form of what was called social engineering during the

Roosevelt era. The original idea was to raise money to pay the costs of government. It was a straightforward concept. Limiting taxes as a safeguard for individual liberty was much in the minds of the founding fathers. They knew that the power to tax was the power to destroy. They understood with great clarity that when the government takes a part of our income, it is commandeering the fruits of our labor.

As early as 1753 Benjamin Franklin suggested a standard. He wrote: "It would be thought a hard government that should tax its people one-tenth of their time, to be employed in its service."

The fundamental principle laid down by our founding fathers has now been reversed. Today, the part of your income you succeed in keeping for yourselves is denounced as a "loophole." The ultimate logic of that assumption is that everything you earn belongs to the state. The benevolent Congress may permit you to keep a little, not as a right, but only as a benefit.

Levying taxes to pay the government's bills is a sound idea. From the very start of our country, however, our toleration of taxes has always been tempered by a well-founded public awareness that government expenditures tend to be too high and to keep rising. When Thomas

Jefferson won election as President in 1800, his campaign promise was to roll back taxes. George Washington was portrayed as a big spender since he had a Federal budget of about 2 percent of the national income. The budget was then financed without income taxes. The well-to-do paid a tax on imported goods, but taxation in America remained light until an income tax was levied to help finance the Civil War. That income tax was repealed in 1872. The Supreme Court found the income tax of 1894 unconstitutional.

It took a Constitutional amendment in 1913 to bring the income tax back into being. Even so, as late as 1935 only one

out of 60 citizens was required to pay any income tax at all. To bear the cost of the New Deal and of World War II, one out of every three--or just about every working adult--began turning a portion of his income over to the government.

No one has to remind you that today, federal, state and local taxes take more than a third of the money Americans earn. While the proportion is large and growing, the point I want to make is that the tax burden does not fall upon people with any semblance of equity. The principal reason that this is so is because tax laws have not been used primarily to raise revenue. Rather, the purpose was to allocate private resources to achieve what were

deemed at the time to be social priorities.

Tax policy aimed at social engineering, instead of raising revenue, inevitably provided individuals and organizations with a patchwork of deductions, exemptions, credits and variable rates of such complexity as to boggle the mind. In moving along this path, Congress stretched the Constitution which speaks only of the "general welfare." Far from looking to the general welfare, the tax laws help develop special interests and privileges. Doubtless, at the time they were enacted into law, each gimmick seemed like a good idea.

But our value systems constantly change; what was once thought to be good

is now denounced. The result is that today's social priorities will inevitably become tomorrow's tax loopholes. Examples abound: the oil depletion allowance was designed to induce people to engage in the financially risky search for petroleum because America needed supplies of energy. When Congress adopted a concurrent resolution in 1945 to allow a deduction for intangible drilling and development costs, the resolution was introduced with the words, "That in the public interest Congress hereby declares . . ." The Arab oil price increase blanked out Congressional memories and turned on a spate of oratory which denounced profits as "obscene" and depletion as a "loophole."

The list of special cases includes just about every category of business, labor or voluntary organization and grows longer with every legislative tinkering. But the point is simple: when the unpleasant job of raising revenue is superseded by government allocation of resources through subsidies, exemptions, loopholes and deductions, we have tax laws which not only can be understood by no one, but with good reason are perceived to be unfair to every sector of our society.

When a democratic consensus believes something is wrong, it is time for reform. Laws which are not only unfair but unintelligible should be

repealed before social damage becomes irreparable.

In the words of the Declaration of Independence the government "has erected a multitude of new offices and sent hither swarms of officers to harass our people, and eat out their substance." That phrase from the pen of Thomas Jefferson sounds like someone who has just heard that the manuals on which IRS agents must rely have grown to an incredible 40,000 pages.

We have arrived at the point where it has been proven the tax machine has been so badly designed that no tinkering can help. It is time to throw the machine away and return to the people the decision

on how they wish to spend their own money.

Just as no-fault auto insurance, despite its deficiencies, leveled premiums for motorists and cut down on endless litigation in the courts, a no-fault tax policy would restore taxation to its original Constitutional purpose of raising revenue and providing for the general welfare. There is much to be said for abolishing the whole complex of laws we now have, and replacing it with a simple graduated rate with no deductions except for taxes paid to other political jurisdictions to avoid paying taxes on taxes. A top tax rate of 20 - 30 percent for individuals and corporations alike

would produce as much revenue as the government now collects. Some have estimated a flat rate of 13 percent would do the job. The exact rate is not as important as the fact that it would make the law clear, certain and fair. It would eliminate loopholes that now make tax laws resemble a sieve.

Since only people pay taxes, the present policy of differentiating between corporate and personal income taxes makes absolutely no sense. In reality, corporate and personal taxes are one and the same. A large percentage of the population has a stake in corporations by either owning shares directly or relying on life insurance and pension funds

which make the investments. In fact, the greatest asset the working man has is a claim on his pension fund in the future. Directly or indirectly, the retired worker must rely on corporate payments for his pension. The majority of jobs in this country are provided by corporations. Whether or not we work for a corporation, we are all consumers, and in the end the consumers pay the corporate tax. If the tax is too high, the buyer pays more for the product of the corporation. If the buyer refrains from buying, the shareholder's dividend declines or evaporates, the working man's paycheck shrinks or disappears. Since it is a truism that no country can be richer than what it can produce, income can be divided

but not multiplied through tax laws.

If the tax rate were the same for corporations and individuals, the shareholder and the working man would have more money to spend, not as the government decides, but as they choose for themselves. Free people making free choices in a free marketplace form the wellspring of our economy. Business would be spurred to research, investment, and development. As a consequence it would hire, compete and produce more and more at less and less cost. This program would answer the fears of a capital shortage, because capital is nothing more than stored up labor: to the extent all people can keep more of the fruits of their labors--more capital is available

to increase production and the quality of life.

This simple but fundamental truth has not been observed by those who determine our tax policy. Voted in response to populist pressure to tap the corporate exchequer, negative sanctions on saving and investment have depleted the public's pocketbook, thrown people out of work, and weakened the economy.

The cold fact is that the Congress, business, labor and individuals have come to have a vested interest in the complexity of the law. The beneficiaries of tax breaks have come to regard them as constitutional rights. Their proponents in the Congress use them as a means to court their constituents and ensure

reelection. Out of habit, the homeowner thinks that his deduction for mortgage interest is all that stands between him and foreclosure. The businessman insists that the investment tax credit is the only thing that stands between progress and stagnation. Doctors and lawyers, farmers and laborers, young and old, rich and poor, all tend to be seduced by "the psychology of entitlement." They have become habituated to look to government to subsidize, directly or indirectly, their education, their homes, their food, their medical care and their retirement. Each person regards the other man's loophole as evil, but his own as essential. Congress, instead of placing a tax

reduction under public scrutiny, all too often prefers obscure subsidies and loopholes with complex credits, deductions, tax carrybacks; they fill the law with these and other riddles. As long as handouts to rich and poor alike are buried in the maze of our tax structure, public confidence in the fairness of the rule of law will continue to decline.

At a time when people grow cynical about all institutions which promise more than can be delivered, it is time for reform. What is needed is a simple, clear tax law, understandable to all, to reduce bias and restore balance. It is time to recognize that freedom and incentives--not tax dodges or loopholes--are what inspire people to work, to save

and to invest. Let us return these decisions to the people by eliminating our present maze of laws and putting in a simple graduated rate unencumbered by exemptions, deductions, deferrals, loopholes, incentives or disincentives. Perhaps then we can begin to repair the social fabric.

Freedom can be as effectively destroyed by a tax policy designed to allocate resources, as by the repeal of the 1st Amendment. When business and personal decisions are made not on economic grounds, but are shaped by tax consequences, which may or may not make any economic sense, our American system of economic and political freedom is in jeopardy. The framers of our Constitution

were well aware of this danger as they were the recipients of discriminatory tax acts promulgated from across the seas. Governments have not mended their ways anymore than human nature has changed. Using tax policy to either force or induce people to do what the government wants, and not what the citizen exercising his free choice wants, is based on the assumption that government knows best. It reflects a distrust of freedom.

A paternal government permitting some favored section of our population to benefit more from the results of their labor than some other section illustrates a point made by the great Justice Louis Brandeis when he wrote: "Experience should teach us to be most on our guard

to protect liberty when the Government's purposes are beneficent. . . The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-meaning but without understanding." Our tax laws are written by men of zeal, and it is equally true that they surpass all understanding.