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The Shelf Project: Revenue-Raising Projects That Defend the Tax Base

By Calvin H. Johnson

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The Shelf Project is a new column in *Tax Notes* to report proposals to help Congress when it is ready to raise revenue in the coming years. Projects will be developed on a wiki, found at http://www.taxshelf.org, and also with committees, organized by subject matter and composed of some of the best tax lawyers in the nation. There is also an award for the best shelf project proposal of the year. This introduction explains the logic and need for the Shelf Project.

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The Shelf Project is a collaboration by professionals in the tax community to develop and perfect proposals that Congress can pull off the shelf when it needs revenue. By some reasonable projections, Congress will need $4 trillion of new revenue over a decade beginning in 2009-2010. Shelf Project proposals will strengthen the tax base, raise revenue, and chase the money.

I. Putting Ideas on the Shelf

Congress needs to have well-developed projects on the shelf when it is ready to raise revenue. Otherwise, it will raise the revenue with whatever is available. Late in the legislative consideration of the Tax Reform Act of 1986 (TRA 1986), for example, congressional staffs were looking for revenue sources to allow for a 25 percent maximum individual tax rate. The staffs had already scoured the code for deductions to repeal, and they were still short. Congress then adopted a terrible proposal, a 5 percent surtax, phasing out personal deductions and low tax brackets.[1] The 5 percent phaseout tax created a bubble in tax rates under which moderately wealthy taxpayers paid a marginal rate that was 5 percentage points higher than the rate imposed on the truly wealthy. There is no economic distinction between just imposing a higher marginal tax rate and a phaseout tax, except that the phaseout tax is more complicated and creates higher tax rates for lower incomes and lower rates for higher incomes. The exemptions for dependents that were targeted by the surtax, moreover, are not loopholes, because it takes considerably more than the amount of the exemption ($3,400 in 2007)[2] to raise a child. No one has a child to get a dependent exemption.[3] In the light of day, the phaseout tax proposal was considered a gimmick, and "insulting to the name of tax reform."[4] The surtax was adopted, however, because it was the only thing left on the shelf.

If there are many good ideas on the shelf, Congress can do some good and defend the tax base as it raises revenue. Section 469, the limitation on passive activity losses, for example, was key to the success of TRA 1986 because it ended tax shelters as they were then known and balanced the revenue lost through cuts in the maximum tax rate. Section 1561, enacted in the Tax Reform Act of 1969 (TRA 1969), ended decades of massive litigation over whether a single corporate group could benefit from many sets of low corporate tax brackets.[5] Section 382, enacted in reworked form in TRA 1986, ended trafficking in net operating losses that had also gone on for decades.[6]

Good Shelf Projects sometimes take years to develop. It took years of tinkering with sections 1561 and 382 before the remedies were effective. Section 469 had to be repaired to handle passive income generators, then more

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[1]TRA 1986, section 101, enacting IRC section 1(g).

[2]Section 3.18 of Rev. Proc. 2006-53, 2007-48 IRB 996, *Doc 2006-22842*, *2006 TNT 218-7* (announcing inflation-adjusted personal exemptions for 2007 at $3,400).

[3] The premise here is that a child is not a decision, but rather a full member of the household entitled to a share of household standard of living, necessarily drawing money away from the standard of living of the income earner.

[4]President Reagan had "ruled out the idea as fraudulent, never guessing the strange ploy would later be picked up, dusted off, and made the law of the land." Jeffrey H. Birnbaum and Alan S. Murray, *Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform* 89, 220 (1987).

[5]Sections 1561-1564 added by TRA 1969. The "vast and complex" law on "multiple surtax exemption " before 1969 is described in James Eustice, "Tax Problems Arising From Transactions Between Affiliated or Controlled Corporations," 23 *Tax L. Rev.* 451, 451 (1966).

[6]Section 382, as amended by TRA 1986, section 621. *See* George K. Yin, "Of Diamonds & Coal: A Retrospective Examination of the Loss Carryover Provisions," 48 *NYU Tax Inst.* 41-1 (1990), which gives a description of the development and adoption of section 382.

commonly known as PIGs.[7] Development of proposals that Congress will adopt in 2009 or 2010 should be started now.

Congress will need to think about raising revenue. Repeal of the alternative minimum tax would cost $668 billion over 10 years.[8] ''Temporary'' rate cuts that Congress adopted in 2001-2005 will expire on December 31, 2010. Taxpayers do not generally know that their current tax rates are just a loaner, not written to be permanent. Just maintaining the ''temporary'' tax cuts will take $300 billion a year.[9] If the cuts are maintained and the AMT is just managed, then Congress will be faced with more than $4 trillion of toxic deficits over the coming decade.[10] Under ''pay as you go'' budgeting, moreover, Congress must raise revenue to spend or give tax incentives for the benefit of constituents.[11] Constituent demands do not stop. It would be a mistake to predict when Congress will turn to revenue raising, but the revenue need is coming.

The projected $4 trillion needed over a decade is a serious number, but not a terrible number. It is *only* $400 billion a year.[12] There is a lot of money in loopholes. The tax expenditure budget identifies some departures from income.[13] I would venture to say that the economy as a whole would be better off if a substantial fraction of those tax expenditures were ended. There are industries and transactions that are undertaxed. There is a desperate need to look at the agriculture, timber, insurance, and energy sectors and determine their real or effective tax rates. Effective tax rate measures how far tax decreases the pretax rate of return, or in many cases, how far tax *increases* return so that investments that would never be made in absence of tax become rational because of tax. The tax system is not the place to determine which industries and investments get subsidies and which do not. Consumption tax norms would tell us to go after interest deductions, consumed capital gains, and monetization of assets with built-in gain. There are many opportunities for negative tax in our current tax law, and a zero tax rate is plausibly the lowest that tax on investments should go. Indeed, if the shelf project can come up with many good and effective ideas, it can help bring maximum tax rates down lower than they have been.

The need for revenue can drive tax reform. Our tax base has eroded. The tax base is assaulted daily by talented tax planners and constituent-demanded legislated exceptions to tax. A good tax base is firm, level among choices, and unavoidable. In our tax system, harmful loopholes abound. The tax base is in terrible health, as measured by how little people are willing to pay for straightforward tax exemption. Investors now need to pay, and are willing to pay, only about 5 percent of interest to avoid tax with municipal bonds.[14] Municipal bonds compete directly or indirectly with all investments, so low implicit tax on those bonds shows that effective tax rates are low on all investments.[15]

It has been more than 20 years since TRA 1986, when Congress last undertook a serious attempt to repair the tax base. The tax base is like an ark on which we all depend. If the tax base is going to hold water, it must be repaired.

The best tax systems have low rates, but are unavoidable. With avoidable taxes, even a small tax rate causes taxpayers to flee. The worst tax systems have high rates in theory, but have planning gimmicks, exemptions, and negative tax for easy substitutes. A loophole-ridden system like ours is a lose-lose situation. Taxpayers do themselves damage avoiding the tax, and the government collects little revenue.

The coming revenue needs are a precious window for the defense of the tax base. Factors that helped tax reform in the past are no longer available. TRA 1986, for instance, was driven by substantial cuts in maximum tax rates that could balance the revenue from anti-tax-shelter reforms. Before 1981, tax brackets were not adjusted for inflation and Congress's need to return the inflation revenues then spurred adoption of antiloophole tax reforms. This time it will be the need for revenue that will have to drive the protections of the tax base. Congress's need for revenue creates a rare opportunity to fill in loopholes. That opportunity for tax reform must not be squandered.

If Congress raises revenue just by raising tax rates, that would be a lost opportunity. An increase in tax rates increases the damage that tax does. The tax-caused deadweight loss rises with the *square* of the increase in tax rates.[16] Raising rates captures those who are in the tax base, to the delight of those who are not. Going after loopholes can raise revenue from the right people and also make the tax system more efficient.

Projects should also follow the dollars. As wealth becomes more concentrated, taxes need to go where the money is. Dollars are more valuable in the hands of the poor, because the poor have so few dollars that they use

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[7]*See* Blake D. Rubin, ''Sticking PIGS: Real Estate Under the Passive Loss Regulations,'' *Tax Notes*, May 16, 1988, p. 867.

[8]Congressional Budget Office, Budget Options (Option 5) (Feb. 1, 2007).

[9]*See, e.g.*, Alex Brill, ''The Individual Income Tax After 2010: Post-Permanence-ism,'' presentation to National Tax Association meeting, May 27, 2007, 60 *National Tax J*. 347, 360.

[10]*See* Alan J. Auerbach, Jason Furman, and William G. Gale, ''Still Crazy After All These Years: Understanding the Budget Outlook,'' *Tax Notes*, May 21, 2007, p. 765.

[11]*See* Heidi Glenn, ''Pay-Go Puts K Street on Guard,'' *Tax Notes*, Mar. 19, 2007, p. 1058.

[12]U.S. Budget, Fiscal Year 2006, Analytic Perspectives 263 (Table 17-1), estimates receipts from corporate and individual income taxes as $1.1 trillion in 2006.

[13]*Id.* at 324 lists ''tax expenditures'' in order of size.

[14]The implicit tax is the difference between Treasury yields and equal risk municipals of the same term, divided by the Treasury yield. Using *Wall Street Journal* figures of Oct. 5, 2007, 30-year Treasury bonds yielded 4.786 percent, and 30-year AAA general obligation municipal bonds yielded 4.54 percent, so the implicit tax is [(4.786-4.54)/4.786] = 5.1 percent. *See* http://online.wsj.com/mdc/public/page/2_3021-bondyield.html?mod=topnav_2_3010#bondyieldA.

[15]Calvin Johnson, ''A Thermometer for the Tax System: The Overall Health of the Tax System as Measured by Implicit Tax,'' 56 *SMU L. Rev*. 13 (2003), explains the logic in greater depth.

[16]*See, e.g.*, Joseph Stiglitz, *Economics of the Public Sector* 376 (1986).

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them for the most desperate needs. The rich value their dollars, and they are very hard to tax. Still, if a person has $50 billion in wealth, there is a restricted amount of love and attention that can be given to any one dollar. If a dollar is needed to pay for the Marines or close the deficit, it does less harm to the sum of human happiness to take the dollar from the top tier of wealth. Moral people now work to shift the tax burden upward. Congress can shift the tax burden upward, raise revenue, lower marginal tax rates, make taxation easier and more efficient, and reduce the damage caused by taxes, all by going after loopholes.

The Treasury Department is the traditional originator of the big tax reform acts. Treasury studies led the way for TRA 1969[17] and the Tax Reform Act of 1976.[18] In 1984 the Treasury Department published a study, often called Treasury I, which was the precursor to TRA 1986.[19] If the Treasury Department were preparing now for the coming revenue needs, then Treasury would be the repository for tax reform ideas. In the absence of Treasury activity, the tax community has to fill in.

The Shelf Project, described here, will support the work of the congressional tax staffs. The Joint Committee on Taxation is statutorily required to study and report to Congress on the tax system.[20] In prior reforms, the staff of the JCT has played a pivotal role. In recent years, the staffs of the House Ways and Means and Senate Finance committees have become important sources of technical support. The Congressional Budget Office also provides important technical support, and its biennial list of budget options includes revenue-raising ideas.[21] The congressional tax staffs, however, sometimes get overwhelmed. The tax community should support them with projects that chase the money, support the tax base, and raise revenue.

Sometime in the future, it may be necessary to shape many different proposals into an overall package with political legs, but in the initial stages, shelf projects need to be pure tax policy, correct on the merits, whether or not they have political appeal.

The tax community that develops shelf projects cannot know or control when Congress will look for revenue. The tax community cannot know what proposals Congress will adopt. But at least Congress should have access in the coming years to sound projects that support the tax base.

II. Tools of the Shelf Project

The Shelf Project will collect and nurture the development of ideas protecting the tax base. Proposals for the Shelf Project must raise revenue, support the tax base, reduce tax-caused harm, and follow the money. The proposals should also simplify the tax law and strengthen its rationales. Often what is needed to make the tax system simple and administrable is a brilliant idea. There is a great deal of talent in the tax community, and many in that community are willing to help improve the tax law.

The Shelf Project has four basic tools: (1) a "wiki," allowing anonymous participants to create and improve projects, (2) a circulation of proposals among experts, and (3) publication of polished proposals in *Tax Notes*, and (4) an award for best project of the year.

A. The 'Wiki'

There is a Web site (http://www.taxshelf.org) that will allow the tax community to develop projects online collaboratively. Wikipedia has proved to be an interesting experiment in which a broad group of people edit encyclopedia entries, and that broad participation allows Wikipedia to cover information that a small group of experts would never have the time to cover. The Shelf Project wiki will be a new experiment for the tax policy community.

To participate in the wiki, the proposals must support the mission of the Shelf Project. They must raise revenue, defend the tax base, reduce tax-caused harm, and chase the money. Participants should have some tax expertise. Tax community members are expected to participate as individuals, representing themselves sincerely and not representing any client or institution that they may be affiliated with. Any participant who is willing to obey the laws is welcome to the community.

Participants can propose or shape Shelf Projects anonymously. Indeed, the debates leading to the adoption of the U.S. Constitution in 1787-1788 were conducted largely via pseudonyms in newspapers and pamphlets. The norms of the time required it. The governing ideal was that error would never prevail "though supported by *dignified* names" and that truth would be victorious, "though it comes from a cottage."[22] It was considered illegitimate to add the weight of name or family to the pure logic of the arguments. And now, there is also no reason to confuse personal belief and one's day job.

The Shelf Project web site will be subdivided into 11 subject matter segments:

1. Individual income tax (including marriage penalty and earned income credit)
2. Tax accounting
3. Consumption initiatives
4. Foreign
5. Financial instruments and institutions
6. Business entities (including partnerships and corporations)
7. Tax-exempt organizations
8. Pensions
9. Estate tax

[17]Department of Treasury, Tax Reform Studies and Proposals (1969).

[18]Department of Treasury, Proposals for Tax Change (Apr. 30, 1974).

[19]Department of Treasury, Tax Reform for Fairness, Simplicity, and Economic Growth (Nov. 1984).

[20]Section 8022.

[21]CBO, Budget Options (Feb. 2007).

[22]Valerius, "Virginia Independent Chronicle," (Jan. 23, 1787), *reprinted in* 8 *Documentary History of the Ratification of the Constitution* 319 (emphasis in the original).

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10. Excise taxes
11. Tax procedure

B. Circulation Among Experts

Some of the best tax lawyers in the country have agreed to assist with the Shelf Project. When the overall project is fully developed, each of the 11 subject matter segments will have two managers who are experts in that area, and a review committee to help. The managers will decide whether the proposals are consistent with the goals of the project and whether they have technical merit enough to recommend them. Every segment of the Shelf Project will have a review committee consisting of experts who will look at projects, circulating drafts among themselves. Each segment is independent and is managed in its own way. I would expect each segment to develop separately.

As of today, the following people have agreed to serve on the Shelf Project within the 11 segments. The segments are listed roughly in the order of how well developed the review committees are, which reflects serendipity and some accidents of my schedule and the schedules of those who are helping. The order does not reflect a judgment about the importance of the area to the tax system or to Congress. We expect to fill in the empty spots as the Shelf Project develops.

1. Financial Instruments and Institutions

Managers:
- Stevie D. Conlon (Arlington Heights, Ill., lead author of *Principles of Financial Derivatives*)
- Reed Shuldiner (University of Pennsylvania Law School)

Review Committee:
- Dale S. Collinson (KPMG, Washington)
- Michael Farber (Davis Polk and Wardwell, New York)
- David Garlock (Ernst & Young, Washington)
- Viva Hammer (Crowell & Moring, New York)
- Jeffrey W. Maddrey (PricewaterhouseCoopers, Washington)
- David S. Miller (Cadwalader, Wickersham & Taft, New York)
- Erika W. Nijenhuis (Cleary Gottlieb Steen and Hamilton)
- William M. Paul (Covington & Burling, Washington)
- Steven M. Rosenthal (Ropes & Gray, Washington)

2. Foreign

Managers:
- Reuven S. Avi-Yonah (University of Michigan Law School)
- Charles I. Kingson (University of Pennsylvania Law School)

Review Committee:
- Peter C. Canellos (Wachtell, Lipton, Rosen & Katz, New York)
- Robert H. Dilworth (McDermott Will & Emery, Washington)
- Joseph H. Guttentag (former Treasury deputy assistant secretary for international tax affairs)
- Stephen E. Shay (Ropes & Gray, Boston)
- Eric M. Zolt (UCLA School of Law)

3. Business Entities

Managers:
- Christopher H. Hanna (Southern Methodist University Dedman School of Law)
- Lawrence Lokken (University of Florida Levin College of Law)

Review Committee:
- Joseph Bankman (Stanford Law School)
- Karen C. Burke (University of San Diego School of Law)
- Jasper L. Cummings, Jr. (Alston & Bird, Raleigh, N.C., and Washington)
- Thomas L. Evans (Kirkland & Ellis, Washington)
- Deborah A. Geier (Cleveland-Marshall College of Law)
- David P. Hariton (Sullivan & Cromwell, New York)
- Jeffrey L. Kwall (Loyola Law School, Chicago)
- Samuel Olchyk (Venable, Washington)
- Michael L. Schler (Cravath Swaine and Moore, New York)
- John P. Steines, Jr. (New York University School of Law)

4. Tax Accounting

Managers:
- Robert M. Brown (formerly of IRS Office of Chief Counsel)
- Joseph M. Mikrut (Capitol Tax Partners, Washington)

Review Committee:
- Sheldon S. Cohen (Washington, former Commissioner of IRS)
- Thomas L. Evans (Kirkland & Ellis, Washington)
- Thomas A. Luxner (Washington, former Branch Chief Income Tax & Accounting, Chief Counsel, IRS)
- Annette B. Smith (PricewaterhouseCoopers, Washington)

5. Tax Procedure

Managers:
- Bryan T. Camp (Texas Tech University School of Law)
- T. Keith Fogg (Villanova University School of Law)

Review Committee
- Steve R. Johnson (University of Nevada, Las Vegas, William S. Boyd Law School)
- Leandra Lederman (Indiana University School of Law — Bloomington)
- Christopher M. Pietruszkiewicz (Louisiana State University Law Center)

6. Tax-Exempt Organizations

Managers:
- Ellen P. Aprill (Loyola Law School, Los Angeles)
- Frances R. Hill (University of Miami School of Law)

Review Committee:
- LaVerne Woods (Davis Wright Tremaine, Washington)
- Christopher M. Jedrey (McDermott Will & Emery, Boston)
- James P. Joseph (Arnold & Porter, Washington)
- Douglas M. Mancino (McDermott Will & Emery, Los Angeles)
- Richard L. Schmalbeck (Duke University School of Law)

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7. Individual Income Tax (Including Earned Income Credit and Marriage Penalty)

Managers:
- Ira B. Shepard (University of Houston Law Center)
- Daniel L. Simmons (University of California-Davis School of Law)

Review Committee:
- Alice Abreu (Temple University Beasley School of Law)
- Martin J. McMahon (University of Florida Levin College of Law)
- Lawrence A. Zelenak (Duke University School of Law)

8. Estate, Gift, and Generation-Skipping Taxes

Managers:
- Carol A. Harrington (McDermott Will & Emery, Chicago)
- Carlyn S. McCaffrey (Weil, Gotshal & Manges, New York)
- John C. McCaffrey (New York)

Review Committee
- Ronald D. Aucutt (McGuire Woods, McLean, Va.)
- Dennis I. Belcher (McGuire Woods, Richmond, Va.)
- Stanley M. Johanson (University of Texas at Austin School of Law)
- Mildred Kalik (Simpson Thacher & Bartlett, New York)
- Lloyd Leva Plaine (Sutherland Asbill & Brennan, Washington)
- Pam H. Schneider (Gadsden Schneider & Woodward, King of Prussia, Pa.)

9. Benefits

Managers:
- Regina T. Jefferson (Catholic University Columbus School of Law)
- Norman P. Stein (University of Alabama School of Law)

Review Committee:
- Deene B. Goodlaw (University of California, Berkeley Law School)
- Daniel I. Halperin (Harvard Law School)
- Nell Hennessy (Fiduciary Counselors, Washington)
- Leon E. Irish (International Center for Civil Society, Washington)
- J. Mark Iwry, (Brookings Institution, former benefits tax counsel, Treasury)
- Alicia H. Munnell (Center for Retirement Research, Boston College)
- Carolyn E. Smith (Alston & Bird, Washington)
- C. Eugene Steuerle (Urban Institute, former deputy assistant secretary for tax policy, Treasury)
- Thomas D. Terry (former benefits tax counsel, Treasury)
- Bruce A. Wolk (University of California-Davis)

10. Consumption Tax Initiatives

Managers:

Review Committee:
- Mitchell L. Engler (Benjamin N. Cardozo School of Law)
- David Elkins (Southern Methodist University Dedman School of Law (visiting professor) and Nettanya College, Israel)
- David A. Weisbach (University of Chicago Law School)

11. Excise Taxes (reserved)

C. Best Proposal Award

An anonymous donor has agreed to fund an award to the best Shelf Project of 2007-2008. Managers and review committees are eligible. The best proposal will serve the missions of the Shelf Project and also should have an element of niftiness in it. The award gives not just the honor but also $1,000.

D. *Tax Notes*

Tax Analysts, the publisher of *Tax Notes*, has agreed to help the Shelf Project. *Tax Notes* will publish the full text of many fully polished proposals under this column. *Tax Notes* will also publish letters in response to proposals. Neither *Tax Notes* nor Tax Analysts is responsible for the contents of specific proposals. Projects under development for the column or comments to Tax Shelf projects can always be found at http://www.taxshelf.org.

III. Format

A standard format helps readers understand what to expect. A Shelf Project proposal should be presented in a form that imitates a committee report, allowing an efficient description of current law, what is wrong with it, and how it would be changed. The format of a proposal should therefore be as follows:

1. *Current Law*. This section should describe the details of current law that would be affected by the proposal and should have cites to authority.

2. *Reasons for Change*. This section should explain why current law needs to be changed.

3. *Explanation of Provision*. This section describes the proposal, beginning with an overview and the most important aspects of the proposal. Any exceptions to the reach of the proposal should be discussed.

4. *Technical Analysis* (if needed). This section explains technical details of the proposal and may be especially necessary if the details would get in the way of explaining the main thrust of the proposal in the Explanation of Provision section.

5. *Notes to Help the Revenue Estimator*. Revenue estimates are critical in the bargaining over tax proposals. Certified revenue estimates are conducted by the JCT, and Shelf Project proposals will have no certified revenue estimates attached to them. An author's notes on revenue estimates, however, can help readers understand the project and see if it is a broad proposal or a narrow one. For some projects, the range of possible revenue might be from $1 million to $100 billion, with not much more specificity.

Conclusion

The tax community needs to lend its expertise to develop and perfect technically sound proposals to raise revenue. Projects that raise revenue, protect the tax base, and follow the money may need a touch of genius to develop, as well as time and care. No one can predict

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when Congress will want to raise revenue, and how much it will be looking for. But when the call comes, Congress needs to have well developed projects on the shelf. It Congress does not have good projects to use when it needs them, it will adopt whatever is available without regard to the technical quality.

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