

COMMENT

REFLECTIONS ON THE REVENUE ACT OF 1964 *

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Public attention to our tax laws has been attracted, as never before, by the lengthy debate over the Revenue Act of 1964.¹ In plain view was demonstrated the difficulty of achieving broad tax reform—even at the price of substantial (\$11.5 billion) rate reduction.

It is in the best interests of our society that non-specialists be kept informed on tax matters. If “war is too important to be left to generals,” so are taxes too important to be left to experts. Knowledge of a subject that affects the entire social and economic fabric of the country should be at the disposal of all interested parties. Current day writers have shown how much of the mystery surrounding tax legislation can be removed. It is from such a perspective that I have prepared this appraisal of our most significant recent tax legislation.

I. ECONOMICS OF REVENUE ACT OF 1964

On February 26th President Johnson signed the Revenue Act of 1964. At the signing ceremony, President Johnson appropriately paid tribute to President Kennedy for his determined efforts to procure the enactment of this important legislation. One of President Kennedy’s early major goals was the strengthening and improvement of the tax structure. Indeed, in 1959, when I was Professor of tax law at the University of Virginia, then Senator Kennedy talked to me about the American tax system and displayed unusual knowledge and concern about the structure of our tax laws and its impact on business and society. His successor has shown himself more than able to carry through these ideals.

As widely publicized, the 1964 tax law contains the largest tax cut in our nation’s history, \$11.5 billion a year when fully effective in

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¹ Pub. L. No. 272, 88th Cong., 2d Sess. (Feb. 26, 1964) [hereinafter cited as Revenue Act of 1964].

1965.² The new tax rate structure is retroactive to January 1, 1964—with individual rates starting at 16% and rising to a top of 77% (instead of prior rates of 20% to 91%), and with corporate rates of 22% to 50% (instead of 30% to 52%). On January 1, 1965, the second and final step of the bill goes into effect. Individual rates drop to a 14% starting point and range to a maximum of 70%; corporate rates begin at 22%, with the maximum at 48%.

The economic philosophy behind the 1964 act has been widely aired. It is summarized in the Senate Finance Committee Report accompanying the tax bill:

The size of tax receipts is attributable to two variables, the tax rates and the tax base. The major thrust of the present tax bill is to provide a long-range expansion in one of these variables—the tax base—and thereby to increase the revenue potential. To accomplish this result the bill encourages the expansion of the private, rather than public, sector of the economy.

The present tax bill, along with a policy of expenditure constraint offers promise of restoring a balanced budget by the fiscal year 1967 or 1968.³

In other words, Congress believes that, in the long run, we will collect more taxes with lower rates. The principle should be readily recognizable to Americans. It shows up in our industrial practice of lowering the cost of items whenever appropriate to increase volume and profits.

The stimulative effect of tax reduction will boost demand and heighten the incentive for investment and risk-taking. It will also alleviate our unemployment and excess capacity problems, encourage modernization and expansion of plant and equipment, and increase the gross national product and national income. In brief, we expect to collect more revenue by creating a larger pool of taxable income to be taxed at lowered rates.

The logic behind this national philosophy approved by Congress is compelling, and the evidence to support its success is encouraging. President Johnson, at his press conference on March 7th, said he was “very pleased by early reaction to the tax cut and to the outlook for the economy in general.”⁴

The President regards the tax bill as the most important domestic measure of the last 15 years. Secretary Dillon sees in it the solution

² N.Y. Times, Feb. 27, 1964, § 1, p. 1, col. 8.

³ S. REP. No. 830, 88th Cong., 2d Sess. 7 (1964).

⁴ N.Y. Times, March 8, 1964, § 1, p. 54, col. 1.

to most of the major economic problems confronting this country—deficits in the federal budget and in our international balance of payments, our high rate of unemployment, the chronic postwar sequence of recession and abortive recovery. Walter Heller, Chairman of the Council of Economic Advisors, predicts that the tax cut will contribute to strengthened and prolonged economic expansions in the United States.

Our economy appears to be on the threshold of a great surge forward, and our position is strengthened by the relative price stability which has prevailed over the past six years. But, we must continue to strive for economy and efficiency in our Government; and we must keep a sharp alert for any inflationary tendencies. Business, labor, and consumer must exercise restraint and must avoid reactivating any price-wage spiral. Government, in turn, must be certain that its fiscal and monetary policies are properly geared to existing conditions.

In brief, we must be sure—preferably on a voluntary, self-policing basis—that our individual actions do not take from us the many gains that this new tax law will provide.

II. STRUCTURAL REVISION AND 1964 REVENUE ACT

Aside from the economics of the 1964 act, many people have questioned whether it made any significant revisions in the structure of our tax laws—whether it effected any tax reform. Some commentators have been critical on this score. One responsible newspaper recently suggested that tax reform was jettisoned. I think this criticism is much too narrow. While the 1964 act is certainly not the “ultimate tax bill,” it does achieve many meaningful and important accomplishments.

Revision of the rate structure, itself, is a significant kind of tax reform; it should not be considered as something apart from the substantive changes in the act. We now have a more realistic series of individual tax brackets, from 14% to 70%. The average reduction is about 19% and is fairly apportioned at all levels. Contrary to some of the published comments, we do not have a “forgotten man” in the middle brackets. We have instead a balance that will provide for increased purchasing power at lower-income levels as well as increased incentives for individual effort, investment, and risk-taking.

Our old rate structure was out of date. It not only derived from the needs of World War II and the Korean War but also had its roots in the economic conditions of the 1930's. But times and society have changed.

Symbolically, under our free enterprise system, a rate schedule that reached 91% in peacetime was too high. We know Congress frequently evidenced its disbelief in this high rate structure. Similarly for corporate enterprises, Congress saw the need to convert the Government from a "senior partner" to a "junior partner," reducing the rates from 52% to 48%.

There are important collateral benefits flowing from rate reduction. It takes the pressure off Congress to provide relief for different groups of activities, which in the past, for example, led to a wide extension of the capital gains concept. It also lessens the incentives for businessmen and tax practitioners to seek such legislative relief, to tailor their affairs to fit into artificial patterns, or to risk experimenting with borderline transactions or tax gadgets.

Rate reduction, in other words, should lessen our intense focus on tax planning and increase our concentration on more productive pursuits. The changes will also contribute to a healthier climate in overall tax administration. Over a twenty-year period, high war-born tax rates had maintained continuous pressure on our citizens. Relief was needed, and it has been generously provided.

Related to the rate changes are the provisions putting corporations on a current tax-payment basis. For individual taxpayers, current payment of income taxes has long been required—through a withholding system, supplemented by quarterly declarations of estimated tax. Now corporations with estimated income taxes over \$100,000 a year also become part of the pay-as-you-go system.

The Revenue Act of 1964 contains a series of "base-broadening" amendments, *i.e.*, provisions which limit special deductions or which tax on the same basis varying types of income, regardless of their source. Worthy of note are the following new provisions:

(1) The dividend received credit is repealed (effective 1965),⁵ but individuals may now exclude the first \$100 of dividend income.⁶ This will increase revenues by \$300 million a year. It results in greater neutrality in our tax system, since it treats income from dividends more like income from wages and salary. As a tax administrator, I might also add that it makes a simplification in the tax return.

(2) The bill taxes compensatory benefits received in the form of group-term life insurance in excess of \$50,000 a year.⁷ While the revenue implications are modest, it establishes an important principle in tax law.

⁵ Revenue Act of 1964, § 201(b).

⁶ Revenue Act of 1964, § 201(c).

⁷ Revenue Act of 1964, § 204(a)(1).

(3) Denied now is the deduction of interest paid on systematic borrowings to pay life insurance premiums.⁸ This eliminates a widely-publicized tax plan which enabled high bracket taxpayers to reduce personal insurance costs.

(4) Also no longer deductible are personal expenditures for a myriad of state and local excise taxes—such as liquor, cigarette, car licenses, and similar excise taxes.⁹ They are difficult for taxpayers to keep track of and for Internal Revenue to police. This will increase Government revenues by \$300 million a year.

(5) A casualty or theft loss is now deductible only to the extent it exceeds \$100.¹⁰ This eliminates the deduction for the ordinary bent fender and solves a troublesome enforcement problem.

(6) The “sick pay” exclusion is narrowed, with more general taxation of wages and salaries received during illness.¹¹

(7) The bill reduces the ability of high-income taxpayers to make unlimited charitable contributions to private foundations, often escaping all income tax liability.¹² It also prevents a charitable deduction for the contribution of expensive art works under arrangements which have been prevalent in the past where the contributor does not give up his present right to enjoyment of the art work.¹³

(8) Substantially tightened are the tax rules governing employee stock options. The option price must at least equal the value of the underlying stock at the date of grant; the option period may not exceed five years; and the stock must be held at least three years.¹⁴

(9) Personal holding companies are more tightly policed, and it will be more difficult to shelter income from the upper individual tax brackets through use of an incorporated pocketbook.¹⁵

(10) The bill eliminates an avenue used by large oil and gas companies to increase percentage depletion allowances. This is done by curtailing the option to group together certain properties.¹⁶ It will increase revenue by \$40 million a year.

⁸ Revenue Act of 1964, § 215(a).

⁹ Revenue Act of 1964, § 207(a).

¹⁰ Revenue Act of 1964, § 208(a).

¹¹ Revenue Act of 1964, § 205(a).

¹² Revenue Act of 1964, § 209(b).

¹³ Revenue Act of 1964, § 209(e).

¹⁴ Revenue Act of 1964, § 221(a).

¹⁵ Revenue Act of 1964, § 225.

¹⁶ Revenue Act of 1964, § 226(a).

(11) Also cut down are some of the advantages of widely advertised real estate tax shelters. Part of the proceeds of sale of real estate relating to "excess" depreciation is taxed as ordinary income.¹⁷

(12) The tax advantages of operating commonly owned businesses through multiple corporations are minimized.¹⁸

In all, the 1964 act made some 40 structural changes in the tax laws. Many resulted in a loss rather than a gain in revenue. Some were aimed at attaining a greater degree of equity, others at relieving specific hardships.

The list above falls in the category of "tax reform" as the term is generally used—involving a tightening up of certain rules. It is an imposing list and represents the largest advance made in some 25 years.

Chairman Wilbur D. Mills of the House Ways and Means Committee recently said: "This bill does carry forward the principle of tax reform. Its benefits, moreover, are carefully balanced."¹⁹ However, he also pointed out:

There's a lot left to be done in the field of tax policy. Many of us would like to see more extensive accomplishments in the area of broadening the tax base by eliminating those differential provisions which have outlived any usefulness they might once have had.²⁰

III. FUTURE OF TAX REFORM

For income taxes, I believe efforts at reform in the near future will be on a piecemeal basis rather than through comprehensive revision—that is, in the absence of a national emergency or a sharp economic or political disturbance.

It is my hope that any such future effort will give special attention to tax simplification. As a tax administrator, I often hear pleas from different parts of the country for simpler tax returns, and we make determined efforts to meet this problem. But, of course, tax returns merely mirror the tax laws—and basic simplification of the tax return must await basic changes in our tax laws.

In our efforts for simplification, we must be on guard against excessive use of the tax system to cure our various social and economic ailments—it is so beguiling to seek a desired solution through a new

¹⁷ Revenue Act of 1964, § 231(a).

¹⁸ Revenue Act of 1964, § 235(a).

¹⁹ Press Release, Feb. 24, 1964.

²⁰ *Ibid.*

tax measure. But, aside from other objections, every such provision—which may be applicable to only a small segment of the population—may have to be added to the tax form and considered by the preparers of the 65 million tax returns filed each year. If we are to have a tax form that can be understood by the average citizen we must resist using the tax laws as a panacea for all our economic and social problems.

Some departure from this principle will be required from time to time. But it should be done with a high degree of selectivity. As President Kennedy indicated in his 1961 tax message, our tax laws should be used to promote desirable social or economic ends only when the “objectives [are] of overriding importance which can be achieved most effectively through the tax mechanism.”²¹

Congress is aware of the desired goal of simplification of our tax laws; but in the world of competing interests—which is inherent in the democratic process—it responds to the group which presents its case most effectively.²² In our democracy, in the long run, we will get the kind of tax system that we demand and deserve. But it is my hope that, in making such demands, we will be careful to balance our own self-interest against the interest of the country as a whole.

²¹ N.Y. Times, April 21, 1961, § 1, p. 18, col. 1.

²² In recent years we have seen a spate of critical books on tax policy. See, *e.g.*, EISENSTEIN, *THE IDEOLOGIES OF TAXATION* (1961); HELLERSTEIN, *TAXES, LOOPHOLES AND MORALS* (1963); MILLIKIN, *THE PRUDENT MAN—TAX DODGING AS AN ART* (1963); STERN, *THE GREAT TREASURY RAID* (1964).