In each issue, *JATA* publishes reviews of textbooks and other books of interest to tax scholars. All book reviews are solicited by the Associate Editor. However, if you know of a book that you would like reviewed, or if you are interested in reviewing a book, please contact the Associate Editor.

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**ALAN J. AUERBACH AND KEVIN A. HASSETT,** *Toward Fundamental Tax Reform*  

With the Bush Administration seeking to overhaul the tax code, the American Enterprise Institute invited nine leading tax policy scholars (seven economists and two lawyers) to prepare position papers reflecting their thoughts concerning fundamental tax reform. This effort culminated in a new book, edited by Alan J. Auerbach and Kevin A. Hassett and titled *Toward Fundamental Tax Reform.* The book, which includes an introduction and a conclusion by the editors, consists of nine essays (i.e., chapters).

In their essays, the authors recognize the significance of generally accepted goals of tax reform such as simplification, capital formation, progressivity, economic efficiency, etc. However, in designing tax reform scenarios they differ on “getting there from here.” Proposals include a flat tax, national sales tax, cash-flow consumption tax, value-added tax, and a modified income tax. Tinkering with the current tax code is preferred by the lawyers, whereas all of the economists favor some form of consumption tax. In this collection of landmark papers, the tax scholars revisit many of the key questions that help frame the debate over tax reform: Is income or consumption the best base for taxation? Should marginal tax rates be progressive or relatively flat? Following fundamental tax reform, would the system once again revert back to complexity, inequality, and special treatment? Would a wholesale change to a consumption tax or a flat tax have a dramatic impact on the U.S. economy? Would income tax reforms that eliminate cherished deductions prove to be beneficial?

Importantly, the authors do not overlook the political environment surrounding tax reform. Clearly, the tax code has been used by Congress as a vehicle toward achieving unlimited social and economic policies for decades. An overview of each author’s view of a desirable tax system is provided next.
David F. Bradford’s essay “A Tax System for the Twenty-First Century” (Chapter 1) is a variant of the Hall-Rabushka flat tax discussed in Chapter 4. In his essay, Bradford lays out a blueprint for replacing the current income tax on individuals and corporations with what he calls the X tax. The X tax has two components: a single rate business tax, applicable to entities of all forms and a compensation tax that, unlike the Hall-Rabushka flat tax, is levied at graduated rates. The latter feature should make the X tax more palatable to the political left. The business component of the X tax is based on the firm’s cash flow from sales less all purchases (including full expensing of capital expenditures) and less employee compensation. The X tax compensation component applies only to worker’s earnings, including pension income. In addition to tax simplification, the X tax, according to Professor Bradford, accomplishes the following: integrates corporation and individual taxation; stops wasteful financial innovation; resolves the interest deduction mess; removes capital gains from the tax base; creates a level playing field for investment; cuts the complexity of retirement saving; and facilitates individual filing.

William G. Gale’s essay in Chapter 2 entitled “Tax Reform Options in the Real World” rejects proposals that would completely replace the existing income tax system. Mr. Gale advocates making the existing system simpler, fairer, and more conducive to economic growth. He would achieve these goals through the following options: (1) integrate the corporate and individual income taxes; (2) integrate the payroll and individual income taxes; (3) simplify the system (i.e., provide for return-free filing); (4) restructure deductions into credits; (5) fix the AMT; (6) raise private and national saving (i.e., automatic enrollment in 401k accounts); (7) improve administration (i.e., provide the IRS with additional resources); and (8) meet government spending needs (i.e., require all individuals to pay an additional 3 percent social security tax on earnings above the current cap). Junking the whole system and starting over could, according to Gale, “create significant administrative, legislative and economic upheavals” (p. 38).

Chapter 3 is entitled “A Fair and Balanced Tax System for the Twenty-First Century” and was written by Michael J. Graetz. He makes it clear that the current income tax is badly broken and that unlike older Americans, young people “feel no compunction about filling out their tax forms dishonestly” (p. 50). Professor Graetz’s new and better tax system has four parts: First, repeal the regular income tax and replace it with a 25 percent AMT that has an inflation-adjusted exemption of $100,000 for married couples and $50,000 for singles. Mr. Graetz estimates that this would free 150 million individuals from filing income-tax returns. Second, lower the corporate income tax rate to 25 percent to match the individual rate and allow the income of small corporations to be taxed on a flow-through basis, thereby taking advantage of the $100,000 income-tax exemption. Third, to replace the tax revenues lost in parts one and two, enact a VAT at a 10–14 percent rate. Fourth, to protect low- and moderate-income families, replace the EITC with a refundable payroll-tax offset. In Professor Graetz’s view, simply replacing the current income tax system with a “flat tax” or a “national sales tax” are not realistic options.

Chapter 4 entitled “Guidelines for Tax Reform: The Simple Progressive Value-Added Consumption Tax” was authored by Robert E. Hall. Although Professor Hall favors a national consumption tax (meaning his own version of the flat tax) as the ultimate goal of tax reform, he emphasizes that not all consumption taxes satisfy the four widely accepted goals of tax reform: simplification, incentives for capital formation, progressive distribution of the tax burden, and economic efficiency. In Professor Hall’s view, both the national sales tax and the cash-flow consumption tax are an administrative nightmare. Furthermore, the European VAT is not progressive. Consequently, all three should be rejected in pursuing...
tax reform. Professor Hall (in collaboration with Professor Alvin Rabushka) has crafted a progressive VAT that, in his opinion, is a desirable goal of tax reform because it meets the four goals of tax reform mentioned above. The progressive VAT is split into two coordinated taxes: one part is a business tax and the second part is a personal tax on compensation. The progressivity results from the fact that low-income workers are exempt from the tax.

It is interesting to note that the editors of the book observe the following in their introduction: “As will be made evident in the chapters that follow, the distinction between a consumption tax and an income tax is at times quite subtle” (p. 5). This appears to be the case with the Hall-Rabushka “flat tax” and the “progressive consumption tax.” Both terms seem to be used interchangeably (some suggest this is a Republican marketing strategy!).

In his essay “Would a Consumption Tax Favor the Rich?” (Chapter 5), R. Glenn Hubbard’s answer is “No,” especially if a consumption tax was levied at graduated rates (i.e., David Bradford’s X tax). In assessing the fairness of the consumption tax base relative to the income tax base, he suggests that the answer depends upon the time frame for analyzing fairness. In other words, consumption taxes “may be less regressive from a lifetime perspective than from an annual perspective” (p. 83). Professor Hubbard focuses much of his attention on capital income taxation. In his opinion the bulk of efficiency gains resulting from fundamental tax reform are achieved by reducing the burden of capital income taxation. Not only does capital income taxation add to the complexity of the current internal revenue code (i.e., measurement of capital gains depreciation), it also suffers from multiple layers of taxation. Although Professor Hubbard concedes that a fundamental reform of the current income tax system can generate economic benefits, the option that generates the greatest efficiency and simplicity gains for both individuals and business entities is the consumption tax.

Casey B. Mulligan’s essay, “Political and Economic Perspectives on Taxes’ Excess Burdens” (Chapter 6), talks about the excess burden of taxes on the private sector. The term “excess burden” is used to describe the fact that a dollar in the U.S. coffers costs the private sector more than a dollar. In other words, according to Professor Mulligan, “collecting an additional $1.00 of personal income tax would cost the private sector at least $1.40, and maybe as much as $3.00” (p. 97). However, he points out that this excess burden could very well be outweighed by the benefits of government spending (i.e., education, defense, elderly assistance, public housing, etc.). Many tax reformers take the position that this excess burden depends in large part on the mix of tax instruments employed. Consequently, it could be greatly reduced by a shift from a progressive income tax to a payroll tax, a flat income tax, and/or a VAT tax.

Chapter 7 was contributed by Ronald A. Pearlman and is entitled “A Tax Reform Caveat: In the Real World, There Is No Perfect Tax System.” Mr. Pearlman, like Mr. Graetz, does not favor a radical change to the current federal income tax system. Although he recognizes that our present law has problems and is in many ways unfair and complex, Professor Pearlman points out that “Americans enjoy the most vibrant economy in the world” (p. 106). Rather than replacing the current income tax (that has a predictable revenue stream) with a consumption-based tax (that has unpredictable behavioral responses), Mr. Pearlman favors broadening the tax base coupled with significant rate reductions. Base broadening could be accomplished by repealing some current itemized deductions (i.e., state and local income taxes and home mortgage interest); limiting exclusions from income (i.e., rethink the tax deferral benefits that whole-life insurance policies and annuities enjoy); and scaling back on the numerous tax credits that the Code offers.
Chapter 8’s essay is entitled “The Elasticity of Labor Supply and the Consequences for Tax Policy” and was authored by Edward Prescott. Professor Prescott reminds his readers “that labor supply is not inelastic and does, indeed, respond to changes in tax rates” (p. 124). This simple principle, according to Prescott can be applied toward restructuring the Social Security Tax System in the United States. Rather than continue to keep cranking up Social Security taxes to salvage the government retirement program (which would affect the labor supply), he recommends establishing a system of mandatory individual savings accounts for retirement. Although this may appear to be a radical approach to reforming the Social Security program, Professor Prescott highlights the fact that some two dozen countries are moving in this direction.

The final chapter (Chapter 9) contains Joel Slemrod’s “My Beautiful Tax Reform.” Professor Slemrod believes strongly that the best tax system may not be the simplest. This position would appear to violate one of the goals of tax reform, which is simplification. However, Professor Slemrod says that “achieving equity and efficiency requires some complexity” (p. 135). As he explains, replacing the current federal income tax with a national retail sales tax (RST) would appear on its face to be a radical simplification. However, to raise the same revenue as the federal income tax, the RST rate would need to be 27 percent or higher depending upon how the base was defined. The chances of a 27 percent RST being successful are rather slim given the fact that “only six countries have operated an RST at a rate over 10 percent, and all but one has since abandoned it” (p. 137). Professor Slemrod is much more comfortable with the value-added tax (VAT) in that it is collected from all business entities (not simply retail establishments) and is currently utilized in over one hundred countries. However, the simplification provided by a VAT does not trump Slemrod’s desire for progressivity of the tax burden.

He recommends cleaning up the tax base for both individuals and businesses. In the end, his tax reform option comes very close to the Hall-Rabushka flat tax or David Bradford’s X tax (i.e., a graduated tax rate schedule applied to the flat tax personal base). The one big exception is depreciation. Under a flat tax capital investments would be expensed, whereas under Slemrod’s proposal they would be depreciated.

In the conclusion chapter, the editors observe that there is no unanimity among the nine tax scholars with respect to the best structure of possible tax reforms. Nonetheless, the editors emphasize that the benefits of fundamental tax reform, like David F. Bradford’s X tax, could be high. However, genuine tax reform means giving up many deductions that American taxpayers consider sacred such as the home mortgage interest and charitable contributions. Consequently, unless tax designers build safeguards into their reforms that preclude future tinkering by politicians, much of their effort will likely be transitory.

The book is well written and clearly provides the reader with a greater understanding of the complexities surrounding tax reform. I would highly recommend it as a supplement to a graduate course on tax policy or as part of a directed readings in taxation class. Furthermore, professors teaching traditional graduate courses in tax such as tax research or the taxation of corporations and shareholders should consider this book for supplemental reading.

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STEVEN A. BANK AND KIRK J. STARK, Business Tax Stories (Foundation Press, 2005, $25.00).

Business Tax Stories, edited by UCLA Law School professors Steven A. Bank and Kirk J. Stark, offers a fascinating glimpse into the origins and evolution of how the United States taxes business enterprises. Certainly, there is no one person who can claim the moniker of being the architect of how the nation taxes businesses (albeit a few people played pivotal roles); many people and factors contributed to this endeavor. The chapters of Business Tax Stories (part of a larger series of books that Foundation Press offers on important cases in various spheres of legal jurisprudence) elaborate how this process unfolded.

This book has many strengths. The editors carefully selected authors who are some of the nation’s best and foremost tax scholars. These authors’ writings are crisp and to the point, and, being from academia, many of the authors offer illustrative examples that make otherwise difficult concepts easy to distill. Furthermore, the chapters are infused with captivating tidbits about well-known cases and historical events that punctuate the otherwise dull and flat with color and dimension; for example, in one chapter, Professor Assaf Kikhovski illustrates how the tax evasion trial of Andrew Mellon may have profoundly influenced the Second Circuit in its rendering of Gregory v. Helvering.

The book’s first six chapters are dedicated to the area of corporate tax. In the book’s first chapter, Professor Reuven Avi-Yonah explores how the corporate income tax initially arose as a means not to raise revenue, but rather to regulate corporate management. Chapter 2, by Professor Ajay Mehrotra, reveals the origins of the Code’s corporate reorganization provisions and how these seemingly innocuous provisions (i.e., limited to those situations in which corporations reincorporated into states that adopted favorable pro-management legislation) grew overnight in size and scope to encompass, for example, mergers and stock swaps. In Chapter 3, Professor Assaf Likhovski discusses one of the most-cited tax cases ever rendered, namely Gregory v. Helvering, and why this decision delivers conflicting messages on the topic of tax avoidance. In the book’s fourth chapter, Professor Herwig Schlunk offers an exposition on General Utilities v. Commissioner, the legislative repeal of what subsequently became known as the General Utilities Doctrine, and the limited impact congressional repeal of this doctrine will have in the area of corporate tax. In Chapter 5, Professor Steven Bank makes a compelling argument that the corporate double tax resulting from the Revenue Act of 1936 was a stratagem on the part of the business community to align its interests with those of shareholders, swinging the pendulum in favor of management retaining corporate earnings. Professor Karen Burke reveals, in Chapter 6, how the IRS’s shortsightedness can sometimes result in big problems, amply illustrated by its “victory” in Hendler v. Commissioner.

The book’s final four chapters are dedicated primarily to the area of partnership taxation. Chapter 7, by Professor Mark Gergen, provides readers with a biography of sorts on the George Washington of partnership taxation, namely Mark H. Johnson, and demonstrates how his perseverance and foresight gave enduring shape to present-day partnership taxation. In the book’s eighth chapter, Professors Laura and Noel Cunningham discuss the importance of Tufts v. Commissioner and attempt to answer several of the issues that this case left unresolved. In Chapter 9, a slight digression from the topic of partnership taxation, Professor Lawrence Zelenak uses Seagram v. Commissioner as an occasion to illustrate the historic and vital role the step transaction doctrine sometimes plays in the taxation of business transactions. In the book’s final chapter, Professor Susan Pace Hamill traces the origin of limited liability companies and how they came to be taxed as partnerships.

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Given the book’s broad array of material, you might expect that a reader would find the reading experience to be somewhat disjointed in fashion. But the authors (and the book’s editors) coherently weave this collage of material into a meaningful picture by showing how cultural, political, and historical items and events interact, creating common dynamics between and among topics. What becomes evident is that no legislative or judicial brushstroke is arbitrary; each is purposeful and is added to complement the picture already emerging on the canvas.

The book’s major virtue is its ability to demonstrate just how formative the early years of business tax were and the importance the precepts developed in these early years continue to play. Figuratively speaking, if Mr. and Mrs. Rip Van Winkle were tax practitioners who fell asleep in 1940 and 1955, respectively, and awoke in 2006, Mr. Rip Van Winkle would readily recognize how the United States taxes corporate enterprises, and Mrs. Rip Van Winkle would be just as adept in the area of partnership taxation. After a double espresso, would each be ready to immediately return to tax practice? No, but with a mere two or three months to brush up on their knowledge, they would probably be ready to hang out their shingles.

In the end, tax professors would be well advised to read this entire book and have their students read select chapters. Adopting this course of action will invigorate classroom discussions and offers participants the opportunity to gain a greater understanding of the origins of our tax system, how it has evolved, and what it may morph into in the future.

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In Fischel’s first book, The Economics of Zoning Laws (1985), he advanced the idea that local governments use their land-use controls in rational, if not always admirable, ways to maximize the value of owner-occupied housing in their community. His second book, Regulatory Takings (1985), investigated the role of the courts in refereeing the division of property interests between private owners of developable land and the public ownership that zoning implicitly confers on the rest of the community.

The Homevoter Hypothesis is Fischel’s third book. The premise of The Homevoter Hypothesis is that homeowners, who are the most numerous and politically influential group within most localities, are guided by their concern for the value of their homes to make political decisions that are more efficient than those that would be made at a higher level of government. Fischel points out that the homevoter hypothesis relies on several other theories. For instance, the economic superstructure for the homevoter hypothesis is the Tiebout hypothesis in which residents “vote with their feet” among communities to select their preferred bundle of public services. He points out that zoning is another critical precondition. That’s because capitalization of good schools into house prices is evidence of an inelastic supply of developable sites. He suggests zoning as the source of the inelasticity. Although it is not explained until well into the book, the median-voter model of politics is also essential to the hypothesis. Fischel points out that the median-voter model is simply the social science name for majority rule. He explains that the householder who had the
median income, or, the median home value in the community would get the public services and taxes he demanded. The model asserts that this result will hold even in representative governments.

In general, I found the book well written and informative. In particular, Chapters 5 and 6 examined the proposition that voters will tolerate property taxes only when the public services financed by them are capitalized in home values. He uses the California's Serrano decision, the subsequent Proposition 13 tax revolt, and the resulting terrible effects on public education to illustrate his point. Some of his points may be contentious, however. For instance on page 138 he justifies his conclusion, in part, by relying on the fact that “non-residential property must be taxed at the same rate as residential.” At least in Massachusetts, this is not the case.

Chapters 7 and 8 discuss the implications of the homevoter hypothesis for local efforts to promote and protect the environment. Fischel concludes that local governments do not sell their environmental souls or those of their neighbors for fiscal or employment gains. The chapter makes several good points including an “aside on the unfairness of tax-base sharing.” Chapter 8 expounds on the points made in Chapter 7 and examines the possibility that one locality may impose the costs of its profitable, but environmentally unfriendly venture, onto its neighbors. Fischel concludes that this “beggar thy neighbor” notion is dubious and offers a debatable explanation as to why it may have happened in a particular example.

The book contains many other interesting chapters although the evidence presented does not always lead directly to the conclusions drawn by Dr. Fischel. For instance, on page 149 he states “If the no-kids-in-public-school majority were solely concerned about their tax bills, they could vote down any increase in school expenditures, either directly or through school board election. But, they do not. Budgets are more likely to have problems in districts with a large no-kids-in-school majority, but even in these some budget is eventually passed. I take this as evidence that schooling’s effect on home values is an important discipline that keeps the no-kids-in-school voters supporting schools even if they aren’t enthusiastic about school taxes.” I see two problems with this conclusion. First, in many towns in Massachusetts, the sole appropriating body is the town meeting. School committees can request particular levels of funding and subsequently arrange expenditures within the eventual appropriation, but the school committee does not set up the budget. Town meeting does. Second, all towns in Massachusetts are required by law to pass a balanced budget. Included in those budgets must be some minimum required per-student spending. Therefore, passing a budget with school spending may not be a show of support by the no-kids-in-school voters, but rather an attempt to comply with state legislation.

Other places where facts are presented with only ad hoc evidence include page 10. There it states “I would point out that both apartment owners and apartment dwellers are rarely NIMBYs (Not in My Back Yards), even after accounting for their lower numbers.” Yet, the author admits he has no statistics on this. This, of course, is an important point because, if it were not the case, it would present evidence against the homevoter hypothesis. In fairness to the author, he does acknowledge that things, other than home values, motivate homevoters. For instance, on page 12 he writes “The importance and vulnerability of their asset are not the only reasons that homeowners are more likely to be the major local political actors. Living in a home for a long time creates a personal attachment for which changes in the neighborhood and community are upsetting.” I also realize that the limitations of space may prevent an in depth analysis of all points raised in the book. For instance, on page 4 he says “[homevoters] will tend to choose those policies that preserve or increase the value of their homes.” Subsequently, he points out that good schools raise home values.
Being from Massachusetts, this made me curious as to how this all jibes with the reluctance of voters to go along with Proposition 2 and ½ overrides for schools. I’m sure there is an explanation, perhaps based on the Tiebout hypothesis. However, the explanation was not put forth in this publication. I think to do so would have strengthened the arguments in favor of the homevoter hypothesis.

Dr. Fischel states his point of view early on in the book and effectively addresses each of his positions. His anecdotes make the book enjoyable to read as well as informative. I think the book would be useful as an elective course supplemental reading or, as part of a reference library. Unfortunately, the book raises many questions that, in the end, remain unanswered. Perhaps, in a future publication, the author will explore some of these issues in greater depth.

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As efforts are made to simplify the federal income tax system, the code becomes more complicated. There is a great need for students and professionals to have an organized method to research and study the tax code. This book provides a factual easy to read methodology for tax research. Supplements are provided for the students and the instructor to reinforce the text material.

The authors divided the book into four sections. The first section provides the reader with general areas of tax practice, ethical responsibilities (including the Sarbanes-Oxley Act in the seventh edition), and a basic methodology of researching with tips for utilizing online tax services. Knowledge of the rules of conduct and ethics is essential to any accounting or legal practice since they are derived from a variety of sources from professional associations to the Internal Revenue Service. The second section defines primary sources, giving the background and the impact of the source on the research. The authors provide an example of many of the sources and make distinctions between the sources. Various research tools are described in the third section, which is enhanced in the seventh edition by adding a section on state tax. The section gives the reader the pros and cons of many different online services. The use of a citator and the information that can be found is explained in easy to understand terms. The last section covers types of communication, tax planning, and potential expectations from the Internal Revenue Service. Sample letters are provided to illustrate proper communication to a client. A short part of the text includes tax planning, which is limited to basic tax-planning techniques. The majority of the section is geared toward the Internal Revenue Service’s effect on examinations of tax returns and potential penalties. Most of the chapters have discussion questions that guide the students’ reading of the chapter for comprehension. The exercises are useful to test the students’ ability to find information online using a variety of sources. The research cases appear to emphasize tax compliance. However, the extensive cases allow the students to use more of their critical-thinking skills as well as their research skills.

There are similarities and differences between the sixth and seventh edition. It appears that most of the questions and problems are the same at the end of each chapter. The
seventh edition has a chapter on state taxes with new exercises and problems. Most of the chapters cover the same material with the exception of a few paragraphs in the seventh edition defining the effect of the Sarbanes-Oxley Act on tax practice. The seventh edition includes tax trivia, which gives an interesting side note to the chapters. The state tax chapter gives an overview of the taxing authority of states. Since each state is individual in its means of taxation, the chapter does provide research tools to gather data for potential cases. There is an interesting section on the legal perspective of state taxes including the limitations of the taxing powers of the states. This section should provide the reader with enough information to want to find out more in this area.

Supplements include TurboTax and access to RIA’s CheckPoint Student Edition online for six months. The TurboTax CD is the business version and does not include the individual tax forms. It would be useful for tax-planning cases and to provide the student with experience using tax preparation programs. RIA’s CheckPoint is limited to selected primary tax law, cases, and rulings. Most colleges and universities libraries have the entire version or have other online tax services.

The detail in the book makes it a good choice for an online course as it provides the student with good direction without class lectures. A “tax tutor” is available online to provide the reader with additional websites for more information and a few questions to start the reader on the use of the websites. At this same web page, the instructor has access to the suggested solutions to the questions, exercises, and problems at the back of each chapter. The book is also a good resource book for the student in other tax courses to assist the student in researching the tax code. There is little need for a yearly update and would therefore be a good purchase for the student’s personal library. Practitioners would also benefit from the book as a resource in the office.

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