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THE NECESSITY OF COMPLEXITY IN THE TAX SYSTEM

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I. INTRODUCTION

The United States' tax system is complex[1] and the Internal Revenue Code (Code) is growing at an alarming rate. There has been an average of more than one change to the Code every single day since 1986.[2] At 3.8 million words in 2010,[3] the Code has grown so long that even the Internal Revenue Service (IRS) has trouble determining how long it is.[4] Constant change and increasing length compound the Code's complexity, which the IRS Taxpayer Advocate identified in 2010 as the most serious problem facing both taxpayers and the IRS.[5] This complexity has resulted in estimated annual compliance costs of up to $431 billion for income taxes alone.[6]

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[1] *See, e.g.*, I.R.C. § 509(a) ("For purposes of paragraph (3), an organization described in paragraph (2) shall be deemed to include an organization described in section 501(c)(4), (5), or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3)."); James Colliton, *Standards, Rules and the Decline of the Courts in the Law of Taxation*, 99 DICK. L. REV. 265, 265 (1995).

[2] THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, THE REPORT ON TAX REFORM OPTIONS: SIMPLIFICATION, COMPLIANCE, AND CORPORATE TAXATION 3 (2010) ("There have been more than 15,000 changes to the tax code since 1986 . . . .").

[3] 1 TAXPAYER ADVOCATE SERVICE, NATIONAL TAXPAYER ADVOCATE 2010 ANNUAL REPORT TO CONGRESS 4 (2010).

[4] *Id.*

[5] *Id.* at 3.

[6] ARTHUR B. LAFFER ET AL., THE ECONOMIC BURDEN CAUSED BY TAX CODE COMPLEXITY 7 (2011), *available at* http://www.laffercenter.com/2011/04/the-economic-burden-caused-by-tax-

With such a vast and complex system, taxpayers will naturally long for simplicity. The desire for simplicity, however, is not new.[7] In fact, no matter how brief earlier versions of the Code may seem now,[8] simplification has always been a concern.[9] The 1939 codification, for example, "was seen as the first important step in simplifying tax administration."[10] Almost forty years later, Congress passed the Tax Reduction and Simplification Act of 1977 with the express intention of simplifying the Code.[11] Again, almost fifty years after the original codification in 1939, the Tax Reform Act of 1986 was supposed to be a "comprehensive revision of the federal tax system, with a goal of fairness, efficiency, and simplicity."[12]

The increasing complexity of the tax system compounded with high unemployment,[13] rising concerns about the nation's budget deficit,[14] and a presidential election have led to a slew of new tax proposals.[15] Recent tax proposals have

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code-complexity/. *See also* THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 3 ("This complexity imposes significant costs on affected taxpayers and is reflected in the amount of time and money that people spend each year to prepare and file their taxes.").

[7] Robert B. Eichholz, *Should the Federal Tax Be Simplified?*, 48 YALE L. J. 1200, 1212 (1939) ("In this country we have heard strident complaints about the complexity of the income tax almost since its inception.").

[8] In discussing whether the Code should be simplified, Professor Eichholz noted in 1939 that "in sheer bulk the income tax act has grown with fearsome rapidity," from seventeen pages in 1913 to 140 pages in 1938. *Id.* at 1201.

[9] *See generally id.*; Rob Bennett, *Complexity Happens*, 45 TAX NOTES 781 (1989); Boris Bittker, *Tax Reform and Simplification*, 29 U. MIAMI L. REV. 1 (1974); Walter J. Blum, *Simplification of the Federal Income Tax Law*, 10 TAX L. REV. 239 (1954); Edward J. McCaffery, *The Holy Grail of Tax Simplification*, 1990 WIS. L. REV. 1267 (1990); Paul R. McDaniel, *Federal Income Tax Simplification: The Political Process*, 34 TAX L. REV. 27, 27–28 (1978); John A. Miller, *Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation*, 68 WASH. L. REV. 1 (1993); Randolph E. Paul, *Simplification of Federal Tax Laws*, 29 CORNELL L. Q. 285 (1944); Sidney I. Roberts et al., *A Report on Complexity and the Income Tax*, 27 TAX L. REV. 325 (1972); Deborah Schenk, *Simplification for Individual Taxpayers: Problems and Proposals*, 45 TAX L. REV. 121 (1989); Stanley S. Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 LAW & CONTEMP. PROBS. 673 (1969); Michelle J. White, *Why are Taxes so Complex and Who Benefits?*, 47 TAX NOTES 341 (1990).

[10] Louis Talley, *CRS Report on History of Federal Taxes*, 2001 TAX NOTES TODAY 19–60 (Jan. 19, 2001), at ¶ 16.

[11] Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126 ("An Act to . . . provide tax simplification and reform.").

[12] Talley, *supra* note 10, at 19–60.

[13] *See, e.g.*, Joshua Zumbrun & Vivien Lou Chen, *Bernake Says High U.S. Unemployment Poses 'National Crisis,'* BLOOMBERG (Sept. 29, 2011, 10:00 PM), http://www.bloomberg.com/news/2011-09-29/bernanke-says-u-s-facing-national-crisis-as-high-unemployment-persists.html.

[14] THE NATIONAL COMMISSION ON FISCAL RESPONSIBILITY AND REFORM, THE MOMENT OF TRUTH 10–11 (2010), *available at* www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf [hereinafter "THE MOMENT OF TRUTH"].

[15] *See, e.g.*, ROMNEY FOR PRESIDENT, INC., BELIEVE IN AMERICA: MITT ROMNEY'S PLAN FOR JOBS AND ECONOMIC GROWTH 37–47 (2011), *available at* http://mittromney.com/sites/default/files/shared/BelieveInAmerica-PlanForJobsAndEconomicGrowth-Full.pdf; JON HUNTSMAN FOR

ranged in size and scope, but almost every proposal calls for a simple and fair tax system.[16] A couple of 2012 presidential candidates took the 1990's idealisms of authors like Peter Drucker[17] and Tom Peters[18] to the extreme and called for a complete abandonment of the current Code in favor of a simpler and fairer system.[19] Ron Paul suggested even more drastic measures such as repealing the Sixteenth Amendment and abolishing income and estate taxes.[20]

Calls for tax reform seek a "simple and fair system." This article argues that such a system is not possible because simplicity conflicts with the systemic goals of certainty and fairness. Part II of this article defines three types of complexity and provides a framework for discussion. It is important to note that throughout this article complexity is discussed in relation to both the Code and the tax system. The tax system reaches beyond the Code and encompasses, among other things, Treasury Regulations, judicial interpretations, the IRS, tax software, and IRS publications, forms, schedules, and worksheets. Most of the examples in this article refer to the Code because recent tax proposals seem to focus on the complexity of the Code's substantive provisions.

Part III looks at the scope of the tax system, progressivity, abuse and the systematic elimination of loopholes, and non-revenue raising uses of the system, and concludes that these forces are inherent causes of complexity in the tax system that will be present in and add complexity to any "new" tax system that results from sweeping reform.

PRESIDENT, TIME TO COMPETE: AN AMERICAN JOBS PLAN 3 (2011), *available at* http://www.jon2012.com/jon-email/TimeToCompete.pdf; PERRY FOR PRESIDENT, GOVERNOR RICK PERRY'S 2020 VISION: CUT, BALANCE & GROW 3 (2011); Rick Santorum for President, *Where I Stand*, RICKSANTORUM.COM (last visited Jan. 26, 2012); Newt 2012, *Solutions, Jobs and the Economy*, NEWT.ORG, http://www.newt.org/solutions/jobs-economy/ (last visited Nov. 21, 2012); THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2.

[16] *See, e.g.*, ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 37–47; JON HUNTSMAN FOR PRESIDENT, *supra* note 15, at 3.

[17] Peter Drucker, *The New Society of Organizations,* 70 HARV. BUS. REV. 95, 97 (Sept.–Oct. 1992) ("Every organization has to prepare for the abandonment of everything it does.").

[18] TOM PETERS, THE TOM PETERS SEMINAR: CRAZY TIMES CALL FOR CRAZY ORGANIZATIONS 16–17 (1994) (proposing that companies need to "abandon" "everything" rather than just "change" to be able to succeed through the technology revolution).

[19] *See* John D. McKinnon, *Cain Plan's Reagan-Era Roots*, WALL ST. J. (Oct. 14, 2011), http://online.wsj.com/article/SB10001424052970204774604576629433751126652.html (describing Herman Cain's proposed "9-9-9" plan); PERRY FOR PRESIDENT, *supra* note 15, at 3–5 (proposing an optional flat tax that could be filed on a postcard). I cannot help but question how Governor Perry's proposal for an optional flat tax system in addition to the current system would simplify anything. If anything, Perry's system would result in more complexity because taxpayers would compute their tax under both systems to determine which resulted in a better outcome.

[20] Ron Paul Presidential Campaign Committee, *The Issues, Taxes*, RONPAUL2012.COM (last visited Jan. 26, 2012).

Part IV discusses the balance of simplicity, equity, and certainty and finds that the necessity of equity and certainty outweigh the benefits of simplicity. This is partially because to achieve the "simple" system discussed in recent tax proposals, the length of the Code would have to be reduced and precise language would have to be replaced with broad and more easily understood language. Broad language, however, is ineffective in creating a fair system and it actually leads to abuse and long periods of uncertainty. Part IV concludes by discussing why the recent tax proposals' focus on complexity of the Code's substantive provisions is misplaced.

The question is not whether tax reform is needed, but how much and in what form. Part V discusses ways to simplify the tax system and asserts that the best reform will take the form of a systematic elimination of inequities and unnecessary complexities in individual Code sections and in the application and implementation of individual Code sections, taking into account how the provisions interact with the rest of the Code. This method of reform avoids the long periods of inequity that could result from enacting broad statutes and simultaneously provides the fairness sought by most of the recent tax proposals.

The systemic desire for equity and certainty make complexity a necessity in the tax system; however, not all complexity is necessary. Part V concludes with a discussion of the unnecessary complexities associated with the education credits and Form 1098-T, and proposes a method of simplifying them.

II. COMPLEXITY DEFINED

Before proclaiming that complexity has "destroyed" the income tax system,[21] or that the best thing to do with the Code is to "[s]crap it, kill it, drive a stake through its heart, bury it and hope it never rises again to terrorize the American people,"[22] it is necessary to understand what complexity means and the context in which it is being discussed. Tax complexity and its counterpart—tax simplification—mean different things to different people.[23] Taxpayers, the IRS, the Treasury, tax preparers, tax attorneys, and tax scholars all view complexity differently.[24] To a tax attorney, complexity may mean that "[a] reasonably certain

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[21] Jeffrey L. Yablon, *As Certain as Death – Quotations About Taxes*, 86 TAX NOTES 231, 238 (Jan. 10, 2000) (quoting Fred T. Goldberg, Jr., former White House Chief of Staff).

[22] *Id.* at 236 (quoting Steve Forbes).

[23] *See* Laurence Woodworth, *Tax Simplification and the Tax Reform Act of 1969*, 34 LAW & CONTEMP. PROB. 711, 711 (1969) ("'[T]ax simplification' means quite different things to different people.").

[24] This is probably the reason why complexity and simplicity have been couched in so many different terms. *See, e.g.*, Samuel A. Donaldson, *The Easy Case Against Tax Simplification*, 22 VA. TAX. REV. 645, 663–64 (2003) ("Mass complexity" is anything that adds to the burden of many taxpayers, such as an additional definition that would cause taxpayers "to spend additional time determining whether and to what extent a provision" applies. "Specific complexity" results when a provision's uncertainty affects "only those taxpayers who face a specific situation that may

conclusion, in some instances, cannot be determined despite diligent and expert research"[25] or that "[a] reasonably certain conclusion can be determined in other instances only after an expenditure that is excessive in time and dollars."[26] To the average taxpayer, complexity is more likely to refer to the navigability of the tax instructions and forms.[27]

No matter who the audience, complexity and simplicity can be seen as the characteristics of the tax system that influence the amount of information and expertise necessary to determine tax liability and to comply with the Code.[28] Complexity has an element of administrability, which refers to the costs of collecting tax payments and enforcing the tax laws.[29] It also has an element of transparency, which "refers to taxpayers' ability to understand how their liabilities are calculated, the logic behind the tax laws, what their own tax burden and that of others is, and the likelihood of facing penalties for noncompliance."[30] In essence, complexity and simplicity are a "gauge of the time and other resources taxpayers spend to comply with the tax laws."[31]

There is a tendency, even among commentators who define complexity, to speak of complexity in its general sense.[32] In specific terms, there is simplification of concept, simplification of language, and simplification of what the taxpayer must do.[33] In other words, there is "structural complexity," "technical complexity,"

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or may not" come within the meaning of the uncertain provision.); Miller, *supra* note 9, at 12 ("Elaborative complexity relates to the level of information and education that must be absorbed in order to begin to decide a tax question. Thus, the length and detail of tax rules, along with their interconnectedness, are directly related to their elaborative complexity. . . . Judgmental complexity refers to the intellectual, moral, and philosophical burdens a tax question may pose for one who has mastered the rules."); Peter H. Schuck, *Legal Complexity: Some Causes, Consequences, and Cures*, 42 DUKE L. J. 1, 2 (1992) (indicating that a legal system is complex to the extent that its rules, processes, institutions, and supporting culture possesses four features: density, technicality, differentiation, and indeterminacy or uncertainty).

[25] Sidney I. Roberts, *Simplification Symposium Overview: The Viewpoint of the Tax Lawyer*, 34 TAX L. REV. 5, 6 (1978); Roberts et al., *supra* note 9, at 327.

[26] Roberts, *supra* note 25, at 6.

[27] *See* Woodworth, *supra* note 23, at 711.

[28] Stanley Surrey & Gerard Brannon, *Simplification and Equity as Goals of Tax Policy*, 9 WM. & MARY L. REV. 915, 915 (1968) ("Simplicity is the characteristic of a tax which makes the tax determinable for each taxpayer from a few readily ascertainable facts.").

[29] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-1009SP, UNDERSTANDING THE TAX REFORM DEBATE: BACKGROUND, CRITERIA, & QUESTIONS 5–6, (2005).

[30] *Id.* at 5.

[31] *Id.*

[32] *See* McCaffery, *supra* note 9, at 1271–72, 1288–89; Surrey, *supra* note 9, at 673 (defining complexity as the '"complex technical structure' of the federal income, estate, and gift taxes").

[33] Paul, *supra* note 9, at 285.

and "compliance complexity." Structural complexity refers to the difficulty "in interpreting and applying rules to economic transactions."[34] Technical complexity refers to the "intellectual difficulty of ascertaining the meaning of tax law."[35] Compliance complexity refers to the "record-keeping and form-completing tasks a taxpayer must perform to comply with the tax laws."[36] Compliance complexity is often discussed in the context of compliance costs such as "the value of time and resources devoted to (1) record keeping, (2) learning about requirements and planning, (3) preparing and filing tax returns, and (4) responding to IRS notices and audits."[37]

While most of the recent tax reform proposals do not state the type of simplicity they are promoting or the specific type of complexity they wish to reduce, it is evident that they are seeking some form of reduction in structural, technical, and compliance complexity. A number of proposals seek to simplify the tax system so that taxpayers can reduce their reliance on tax professionals and file their own taxes.[38] Essentially, these plans seek to reduce the structural, technical, and compliance complexity of the system so that taxpayers can more easily interpret, apply, and comply with the tax laws. It is also evident, based on the express desire in the plans to eliminate the need for tax professionals, that the context of reducing complexity should focus less on the tax expert and more on the knowledge and perceptions of taxpayers. It is in this context that complexity is discussed in this article.[39]

III. THE INHERENT CAUSES OF COMPLEXITY

The tax system is complex for countless reasons. The concept of realization,[40] cash basis accounting,[41] the prepayment of taxes, [42] the use of net income in determining tax liability,[43] and the process of developing tax policy[44] all contribute

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[34] McCaffery, *supra* note 9, at 1271.

[35] *Id.*

[36] *Id.* at 1271–72. These concepts have also been referred to as transactional complexity, rule complexity, and compliance complexity. *See* Schenk, *supra* note 9, at 127.

[37] U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 29, at 46.

[38] *See* ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 37–47; PERRY FOR PRESIDENT, *supra* note 15, at 3–5.

[39] This article speaks in terms of complexity; even so, it is important to note that while complexity and simplicity are often seen as opposites, they are inherently related and one cannot be mentioned without thinking about the other.

[40] *See* Bittker, *supra* note 9, at 3.

[41] *See id.* at 3–4.

[42] *See* Paul, *supra* note 9, at 288.

[43] *See* Eichholz, *supra* note 7, at 1211–12 ("But since we have a revenue law which measures taxable capacity by so complex a standard as net income, that law cannot and should not be simple in structure.").

[44] Surrey, *supra* note 9, at 689–93, 696–97.

to the system's complexity. While there are other more skeptical theories for the causes of complexity,[45] the scope of the tax system, progressivity, abuse and the systematic elimination of loopholes, and non-revenue raising uses of the tax system are the most noteworthy.

A. The Scope of the System

The tax system is vast in scope and, for such a system to be applied fairly to both complex and simple transactions, it must be complex.[46] A United States citizen can go a lifetime without personally experiencing bankruptcy, divorce, or the intricacies of maritime law; however, tax law is unavoidable because it affects everyone. The Code defines gross income as "income from whatever source derived."[47] Gross income also applies to income earned worldwide and taxpayers report it on an annual basis.[48] As a result, in 2010[49] alone there were over 230 million tax returns filed with the IRS.[50]

The Code must account for the ways in which *every* individual and *every* business operates. With over 313 million people[51] affected by the Code and over $2.345 trillion in gross collections in 2010 alone,[52] complexity is a necessity in the

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[45] *See* White, *supra* note 9, at 342 (proposing that "revolving door lawyers working for the IRS have an incentive to write complicated regulations so that when they leave for the private sector, they can sell their services as the only person knowledgeable about 'their' regulations;" that "[m]embers of the congressional tax-writing committees 'sell' tax benefits to lobbying groups in exchange for campaign contributions;" and that the IRS prefers complex tax law "because it enables the IRS to collect more in disputes with taxpayers"). It is important to note that Ms. White's analysis in *Why are Taxes so Complex and Who Benefits?* is based on the type of legal analysis that Professor Zelenak would likely consider to be done without a "detached and disinterested frame of mind." *See* Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1521, 1578 (1998). This is partially evident by Ms. White's failure to mention that the IRS only collects about three percent of tax revenue as a direct result of enforcement actions. *See Hearing on Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due Before the S. Comm. on Finance*, 112th Cong. 1 (2011) (statement of Nina E. Olson, National Taxpayer Advocate, IRS), *available at* http://www.irs.gov/pub/irs-utl/nta_testimony_taxgap_062811.pdf [hereinafter "*Hearings*"].

[46] *See* Surrey, *supra* note 9, at 686 ("The aspect of complexity breeding complexity is in large part a result of the fact that our complicated tax rules are applicable to an enormously complex economic and legal system.").

[47] I.R.C. § 61(a).

[48] *See id.* §§ 1, 11, 61(a), 63(a). The Code also applies to individuals without taxable income. *See, e.g.*, *id.* § 25A (detailing the partially refundable American opportunity credit).

[49] The fiscal year runs from October 1, 2009 to September 30, 2010. IRS, PUBLICATION 55B: INTERNAL REVENUE SERVICE DATA BOOK i (2010).

[50] *Id.* at 3–4.

[51] U.S. Census Bureau, *State & County QuickFacts*, CENSUS.GOV, http://quickfacts.census.gov/qfd/states/00000.html (last updated Sept. 18, 2012, 4:41 PM).

[52] IRS, PUBLICATION 55B: INTERNAL REVENUE SERVICE DATA BOOK 3–4 (2010).

tax system.[53] Technical complexity is added in the text of the Code to differentiate transactions and their treatment from one another. At the same time, structural complexity is added because taxpayers have to determine what rules apply to each transaction. Finally, compliance complexity is added to account for not only the differences in transactions, but also the sheer volume of transactions.[54] Since the IRS only examines about one percent of all tax returns per year,[55] recordkeeping requirements, such as third-party information returns, have to be added to keep the system running effectively.[56]

The necessity of complexity can be easily illustrated through a discussion of real estate transactions. To adequately address real estate transactions, the tax system must address, *inter alia*, whether property is used in a trade or business,[57] for residential,[58] investment,[59] or rental purposes,[60] and whether the owner is an alien,[61] individual,[62] joint tenant with right of survivorship,[63] partnership,[64] C-corporation,[65] S-corporation,[66] or Real Estate Investment Trust.[67] The system

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[53] *See* Bittker, *supra* note 9, at 2 ("When such a tax is imposed on tens of millions of taxpayers at rates yielding tens of billions of dollars, only an incorrigible optimist could expect the kind of simplicity that can be achieved with a poll tax, or that is characteristic of local real property and sales taxes."); Donaldson, *supra* note 24, at 661 ("The Code is complicated because of the significant revenues it produces. . . . As long as society changes and the economy becomes more sophisticated, so too should the Code.").

[54] The Code has to be written to apply to every transaction in a country with a gross domestic product of over fifteen trillion dollars. *See* U.S. Department of Commerce, Bureau of Economic Analysis, *Gross Domestic Product (GDP), Current-dollar and "real" GDP*, BEA.GOV, http://www.bea.gov/national/ (last updated Nov. 30, 2012) [hereinafter "*Gross Domestic Product*"]. As a result, in 2010 there were over 2.6 billion third-party information returns and 141 million individual tax returns. *See* IRS, PUBLICATION 55B: INTERNAL REVENUE SERVICE DATA BOOK 3–4, 35 (2010).

[55] IRS, PUBLICATION 55B: INTERNAL REVENUE SERVICE DATA BOOK 21 (2010).

[56] *See* Roberts et al., *supra* note 9, at 328 (indicating that any weakening of the perceived fairness and integrity of the system affects the attitude of the public and can lead to an increased reduction in compliance). Record-keeping requirements not only help keep the honest man honest, but they provide a way to detect taxpayer noncompliance. In 2010 alone, the IRS's Automated Underreporter Program and Automated Substitute for Return Program used third party reporting data to detect and close 5.5 million cases of noncompliance. *See* IRS, PUBLICATION 55B: INTERNAL REVENUE SERVICE DATA BOOK 35–38 (2010).

[57] *See* I.R.C. § 1231.

[58] *See id.* §§ 121, 163(h), 262.

[59] *See id.* § 1221(a).

[60] *See id.* § 280A(c)(3).

[61] *See id.* § 897.

[62] *See id.* §§ 121, 163(h), 262.

[63] *See id.* § 1237.

[64] *See id.* § 723.

[65] *See id.* § 351.

[66] *See id.* § 1367.

[67] *See id.* §§ 856–860.

has to take into account what happens to a buyer and seller (or lessee and lessor) with a lease,[68] lease option,[69] outright sale,[70] installment sale,[71] sale-leaseback,[72] and synthetic lease.[73] The tax system also has to address how property is used,[74] financed,[75] and transferred[76] (including whether by abandonment,[77] sheriff's sale, auction, short sale, adverse possession,[78] gift,[79] inheritance,[80] or between related parties[81]). To the extent that these (and other) differences in real estate transactions are material enough to warrant differing tax treatment, complexity has to be added to the tax system to address them.[82]

The recent calls for reform focus on the tax system for a reason. Tax law is not the only complex area of law, it is not the only area of law with frequent changes, and it is certainly not the only area of law where hiring an attorney can be beneficial in interpreting the law.[83] Despite the complexity of other areas of law,[84] widespread calls for reform are most prevalent in tax. Such a widespread consensus is likely attributable to the scope of the tax system and its applicability to a large and complex society. In 1927, the Joint Committee on Internal Revenue Taxation recognized that "while a degree of simplification is possible, a simple income tax for complex business is not."[85] In 1927 the Code was less than 140

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[68] *See* Treas. Reg. §§ 1.263(a)-(4)(b), 1.461-1(a)(1).

[69] *See* I.R.C. § 1234.

[70] *See id.* §§ 61(a)(3), 1001(a).

[71] *See id.* § 453.

[72] *See, e.g.*, Frank Lyon Co. v. United States, 435 U.S. 561, 583–84 (1978).

[73] *See* I.R.S. Tech. Adv. Mems. 97-48-005 (Aug. 19, 1997), 98-02-002 (Sept. 18, 1997).

[74] *See, e.g.*, I.R.C. §§ 280A(c), 469.

[75] *See, e.g.*, Treas. Reg. § 1.1001-2(a)(1).

[76] *See, e.g.*, I.R.C. § 1031.

[77] *See* Treas. Reg. § 1.165-2(a).

[78] *See, e.g.*, IRS, PUBLICATION 4681: CANCELED DEBTS, FORECLOSURES, REPOSSESSIONS, AND ABANDONMENTS (2012).

[79] *See* I.R.C. § 2503.

[80] *See id.* §§ 1014, 2037.

[81] *See id.* § 267.

[82] Michelle Arnopol Cecil, *Toward Adding Further Complexity to the Internal Revenue Code: A New Paradigm for the Deductibility of Capital Losses*, 4 U. ILL. L. REV. 1083, 1086 (1999) (indicating that much of tax law complexity is inevitable because human circumstances and financial transactions take so many forms).

[83] *See, e.g.*, Donaldson, *supra* note 24, at 734–35.

[84] Bankruptcy and maritime immediately come to mind.

[85] THE JOINT COMMITTEE ON TAXATION, 70TH CONG. 1, REP. OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION 7 (Comm. Print 1927), *available at* http://www.jct.gov/publications.html?func=startdown&id=4280 [hereinafter "THE 1927 REPORT"].

pages,[86] the nation's gross domestic product was less than one percent of what it is now,[87] and the telegraph was a growing form of communication.[88] Although business is more complex today than it was in 1927, the message of the 1927 Joint Committee still holds true today.[89] To implement a tax system equitably across the vast array of people and circumstances in this country, the tax law and its administration has to be complex enough to differentiate between simple and complex transactions. Further, it must be extensive enough to cover the vast array of transactions that take place in a complex society.

B. Progressivity

Complexity is a natural byproduct of progressivity. Progressivity, which is generally justified on equity and "ability to pay" principles,[90] is the idea that as income increases,[91] average tax rates should also increase.[92] In layman's terms, it is an extension of the idea that "Americans must first be able to feed, clothe, and house their families before they are asked to feed the federal spending machine."[93] Progressivity adds complexity to the tax system because it requires the Code to differentiate between taxpayers with different incomes[94] and therefore generates income avoidance techniques[95] that can be dealt with only by adding complexity to the tax system.

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[86] *See* Eichholz, *supra* note 7, at 1201.

[87] *See Gross Domestic Product*, *supra* note 54.

[88] *See generally* U.S. CENSUS BUREAU, CENSUS OF ELECTRICAL INDUSTRIES 1927: TELEGRAPHS, *available at* http://www.census.gov/prod/www/abs/decennial/special.html.

[89] *See* THE 1927 REPORT, *supra* note 85, at 7 ("The task is to simplify the law and the administration for all taxpayers so far as possible, without causing real hardship to those with complex sources of income and varied business enterprises who cannot be taxed justly under a simple, elementary law.").

[90] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 29, at 27; Cecil, *supra* note 82, at 1091; McCaffery, *supra* note 9, at 1280–81, 1283.

[91] THE JOINT COMMITTEE ON TAXATION, 104TH CONG. 1, DESCRIPTION AND ANALYSIS OF PROPOSALS TO REPLACE THE FEDERAL INCOME TAX 59 (Comm. Print 1995) ("An average income tax rate is the taxpayer's total income tax liability divided by his total income.") [hereinafter "THE 1995 REPORT"].

[92] *See id.*; Donna M. Byrne, *Progressive Taxation Revisited*, 37 ARIZ. L. REV. 739, 742–47 (1995).

[93] The National Commission on Economic Growth and Tax Reform, *Unleashing America's Potential: A Pro-Growth, Pro-Family Tax System for the 21st Century*, 70 TAX NOTES 413, 422 (1996).

[94] Differentiating between taxpayers creates difficulties because it can be difficult to determine when two individuals are similarly situated, and because people disagree over whether individuals are similarly situated when they have similar income but different types of expenses. *See* THE 1995 REPORT, *supra* note 91, at 72.

[95] *See* Bittker, *supra* note 9, at 4.

Progressivity, and specifically progressivity through the use of marginal tax rates, leads to taxpayer attempts to shift income to taxpayers in lower tax brackets.[96] For example, without section 1(g) of the Code, marginal tax rates would invite parents to shift income to children in lower tax brackets because high-income parents could shelter income simply by transferring income-earning assets to their minor children in a lower tax bracket. Section 1(g) avoids this result by taxing "net unearned income" at the parent's highest marginal tax rate.[97] While section 1(g) limits taxpayers' ability to take advantage of progressivity in the system, it also adds complexity to the tax system by adding another provision that taxpayers have to interpret, assess, and comply with when tax planning and determining tax liability.

Progressivity also adds complexity by differentiating taxpayers based on ability to pay. Complexity based on ability to pay often comes in the form of deductions, credits, and phaseouts. Deductions and credits can be used to lower or offset a taxpayer's tax liability by targeting circumstances that reduce a taxpayer's ability to pay. For example, deductions for dependents[98] can be justified on ability to pay principles because supporting a dependent requires paying expenses, which in turn reduces a taxpayer's ability to pay tax.[99] Although individual deductions and credits may not have technical complexities, the addition of deductions and credits will generally add compliance complexity to avoid abuse.[100] Structural complexity also results due to an increase in the number of rules with which taxpayers have to familiarize themselves and comply.

Deductions, such as the deduction for dependents, are at times accompanied by a phaseout, which adds technical complexity to the tax system.[101] A phaseout is a reduction in an allowable deduction or credit as a taxpayer's income increases past a specific threshold.[102] Phaseouts are progressive because they provide for an increase in effective tax rates through the reduction of deductions and credits based on an increase in income.[103] Phaseouts are necessary to promote progressivity because individual credits and deductions cannot be progressive unless they

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[96] McCaffery, *supra* note 9, at 1283.

[97] *See* I.R.C. § 1(g).

[98] *See id.* §§ 151–152.

[99] *See, e.g.*, Schenk, *supra* note 9, at 132 (noting that the theoretical underpinning for a deduction for individuals with dependents is the individual's ability to pay).

[100] *See, e.g.*, I.R.C. § 32(c)(1)(E), (m) (denying a credit for individuals who do not include their social security number on the return).

[101] *See* I.R.C. § 151(d)(3).

[102] *See* Charles Hartman, *Missed It by That Much—Phase-Out Provisions in the Internal Revenue Code*, 22 U. DAYTON L. REV. 187, 188–89 (1996).

[103] *See* Byrne, *supra* note 92, at 742–47.

are accompanied by a phaseout.[104] Unfortunately, phaseouts add structural and technical complexity to the tax system. Technically complex rules are required to differentiate between taxpayers and to provide for proportional reductions in tax benefits (as opposed to "hard" cutoffs where an extra dollar in income can eliminate a tax benefit). Phaseouts can add an extra layer of complexity in provisions that already seem complex.[105]

While progressivity has been studied at length[106] and there are numerous arguments for[107] and against it,[108] it is sufficient to say that in general, progressivity has been widely accepted in the United States.[109] Despite its widespread acceptance, progressivity is also "widely believed to be responsible for much of the complexity of the tax system."[110] The complexity associated with "gifts, trusts, family partnerships, loans at below-market rates of interest, unearned income of minor children, and divorce or separation agreements," for example, has all been attributed to progressivity.[111] This added complexity is a direct result of the inverse relationship between simplicity on one hand and equity and certainty on the other. As Congress adds and modifies provisions to provide progressivity, simplicity decreases, and thus, the tax system becomes more complex. Given its

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[104] In fact, deductions without a phaseout may be regressive because the value of a deduction increases as a taxpayer's marginal tax rate increases.

[105] For example, the phaseout of the earned income tax credit, I.R.C. § 32, adds technical and structural complexity to a provision that is already considered by many to be overly complex. *See, e.g.*, Danshera Cords, *Paid Tax Preparers, Used Car Dealers, Refund Anticipated Loans, and the Earned Income Tax Credit: The Need to Regulate Tax Return Preparers and Provide More Free Alternatives*, 59 CASE W. RES. L. REV. 351, 365–70 (2009); William Drennan, *Strict Liability and Tax Penalties*, 62 OKLA. L. REV. 1, 47–48 (2009); Anthony Infanti, *Inequitable Administration: Documenting Family for Tax Purposes*, 22 COLUM. J. GENDER & L. 329, 425–26 (2011).

[106] *See, e.g.*, Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905 (1987); Walter Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417 (1952); Jeffrey Schoenblum, *Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals*, 12 AM. J. TAX POL'Y 221 (1995); Cecil, *supra* note 82, at 1090–95.

[107] *See* Blum & Kalven, *supra* note 106, at 417.

[108] *See generally* Bankman & Griffith, *supra* note 106 (indicating that progressivity leads to a decline in labor, complexity, encouragement of tax shelters, and decreased compliance).

[109] *See, e.g.*, Blum & Kalven, *supra* note 106, at 417 ("Progressive taxation is now regarded as one of the central ideas of modern democratic capitalism and is widely accepted as a secure policy commitment which does not require serious examination."). Progressivity has not only been widely accepted, it "has been part of the federal income tax system since its inception in 1913." Bankman & Griffith, *supra* note 105, at 1906.

[110] Bankman & Griffith, *supra* note 106, at 1929.

[111] *See id.* at 1930–31.

general acceptance[112] despite its known propensity to cause complexity,[113] it is likely that no matter what changes Congress makes to the tax system, progressivity will continue to complicate it.

C. Abuse and the Systematic Elimination of Loopholes

The elimination of taxpayer abuse and loopholes[114] adds complexity to the tax system. "To most Americans, fairness means that the rules apply to everybody and everybody plays by the rules."[115] It is no wonder then why there has been a longstanding concern about identifying and closing tax loopholes.[116] Lawyers, taxpayers, accountants, and even the Treasury painstakingly search the Code for ways to take advantage of gaps and ambiguities in the system.[117] The Treasury monitors the Code for potential abuse and requests Congress to make changes to eliminate areas of abuse.[118] Meanwhile, risk-loving, aggressive taxpayers are playing into the audit lottery[119] and weighing the economic benefits of tax strategies against the odds and costs of being audited, caught, and forced to pay more than they otherwise would have saved by the strategy.[120] The audit lottery and self-reporting nature of the tax system permit aggressive taxpayers to test the system and take advantage of ambiguity; the concern for fairness requires

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[112] *See, e.g.*, William Safire, *The 25% Solution*, N.Y. TIMES, Apr. 20, 1995, at A23 ("Most of us accept as 'fair' this principle: the poor should pay nothing, the middlers something, the rich the highest percentage.").

[113] *See* Bankman & Griffith, *supra* note 106, at 1930–31.

[114] Some commentators treat all deductions, preferences, and tax breaks as "loopholes." *See, e.g.*, J. BIRNBAUM & A. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM 16 (1987) ("It was this pinstriped-suited group that gave birth to the biggest business tax break ever adopted—the accelerated cost recovery system, a loophole so large that it allowed many big, profitable corporations to slip through without paying a penny in corporate tax."); ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 51 (excerpt by Scott McNealy) ("[L]oopholes favor those with the best lobbyists. If we close loopholes and lower the tax rate, the American people and corporations will win."). I view loopholes not as the provisions that are intended to benefit specific types of taxpayers, but the provisions that unintentionally permit taxpayers to achieve tax benefits not contemplated by the provision.

[115] The National Commission on Economic Growth and Tax Reform, *supra* note 93, at 421.

[116] *See, e.g.*, Eichholz, *supra* note 7, at 1210–14.

[117] *See* Colliton, *supra* note 1, at 325–26.

[118] *Id.* at 325; Roberts et al., *supra* note 9, at 338.

[119] The "audit lottery" or "tax lottery" has been described as a series of questions taxpayers face when confronting a doubtful tax issue prior to preparing an income tax return:

> (1) Will his return be selected for audit? (2) If so, will the agent be sufficiently skilled to discover the issue? (3) If so, can the issue be resolved at less than the full tax on the basis of trial hazards? (4) If not, will the government counsel make the telling contentions to the court? (5) If so, will the court understand the issue?

Roberts, *supra* note 25, at 9–10; *see also* Roberts et al., *supra* note 9, at 329–30.

[120] McCaffery, *supra* note 9, at 1289–90.

eliminating such ambiguity. This cycle of abuse and the systematic elimination of ambiguity that leads to abuse add significant complexity to the system.

To eliminate loopholes and abuses, Congress must either repeal or amend provisions containing loopholes. Assuming the original provisions serve a valid purpose, the latter option is the only legitimate way to eliminate loopholes and still permit the intended uses of the provisions.[121] Because the devices used to take advantage of loopholes are intricate, the amendments addressing loopholes must also be intricate.[122] As taxpayers unearth new loopholes, Congress makes changes to the tax laws to avoid and close loopholes, and the result is a frequently changing Code with a predisposition toward detailed, complex provisions.[123] These intricacies add technical complexity to the Code, which in turn adds structural complexity for taxpayers who have to determine if their activities fall within the gambit of such intricacies. Compliance complexity is also added in the form of more guidelines, tax forms, and filing requirements. Despite the significant added complexity and the overall concerns for simplicity in the Code, taxpayers generally prefer complexity to even marginal horizontal inequity.[124]

D. Non-revenue Raising Uses of the Tax System

Non-revenue raising uses of the Code increase complexity in the tax system. Although the primary purpose of the tax system is to collect revenue,[125] Congress also uses the system to promote and discourage certain behaviors, attain social and economic goals,[126] and occasionally help individual taxpayers.[127] These non-revenue raising uses of the tax system are made visible through the identification and reporting of tax expenditures. "Tax expenditure" is a label attached to certain

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[121] Blum, *supra* note 9, at 253; McCaffery, *supra* note 9, at 1276; Surrey, *supra* note 9, at 682.

[122] Eichholz, *supra* note 7, at 1210.

[123] *See* Colliton, *supra* note 1, at 269 ("Throughout the history of tax law, Congress has consistently replaced general standards, whether judicial or statutory, with detailed, precise rules."); Donaldson, *supra* note 24, at 659 (indicating that frequent changes to the Code inevitably add to its complexity).

[124] *See* Schenk, *supra* note 9, at 123 ("[T]axpayers appear to tolerate significant complexity in order to eliminate marginal horizontal inequity. More importantly, taxpayers generally are unwilling to sacrifice tax benefits to achieve simplicity."); Surrey, *supra* note 9, at 701 (indicating that when straddled with the choice between added complexity and unfairness, Americans have chosen complexity).

[125] U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 29, at 5; Eichholz, *supra* note 7, at 1202.

[126] THE 1995 REPORT, *supra* note 91, at 59; U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 29, at 10; Colliton, *supra* note 1, at 327; Roberts et al., *supra* note 9, at 345; Surrey, *supra* note 9, at 683.

[127] *See* Note, *Tax Equity and Ad Hoc Tax Legislation*, 84 HARV. L. REV. 640, 644 n.15 (1972).

exclusions, deductions, and credits that have the effect of reducing the tax collected while presumably furthering some other goal.[128]

Congress has extensively used tax expenditures in recent years and there are no signs of the trend slowing. There were an estimated sixty-six tax expenditures set to expire in 2010 and 2011;[129] however, the total number of tax expenditures grossly outnumbers the number of expiring tax expenditures. The Staff of the Joint Committee on Taxation recently listed fourteen pages of tax expenditures totaling trillions of dollars for fiscal years 2011–2015.[130] That list did not even include the thirty-three tax expenditures for which quantification was not available or the thirty-four *de minimis* expenditures that amount to less than fifty million dollars each.[131] The exclusion for employer-paid health insurance,[132] exclusion for contributions to retirement accounts,[133] deductibility of mortgage interest on owner-occupied homes,[134] accelerated depreciation,[135] and deductibility of charitable contributions[136] are some of the non-revenue raising uses of the tax system that add to its complexity. The tax system grows and becomes more complex every time Congress uses it to achieve social or economic goals.[137] Taxpayers have to deal with the added technical complexity of trying to understand the provisions, added structural complexity of trying to ascertain and learn the requirements of a larger body of law, and added compliance complexity in the form of additional record keeping and form completing requirements. Given the extensive use of tax expenditures and non-revenue raising uses of the Code, complexity is inevitable in the tax system and it will be prevalent no matter what system is used.

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[128] There is no official definition of what constitutes a tax expenditure, so the classification of items as tax expenditures can vary. The Congressional Budget and Impoundment Control Act of 1974 defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Pub. L. No. 93-344, § 3(3). "A tax expenditure is measured by the difference between tax liability under present law and the tax liability that would result from a recomputation of tax without benefit of the tax expenditure provisions." THE STAFF OF THE JOINT COMMITTEE ON TAXATION, 112TH CONG. 2, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2011–2015 25 (Comm. Print 2012) [hereinafter "THE 2012 REPORT"].

[129] THE 2012 REPORT, *supra* note 128, at 17–22.

[130] *See id.* at 32–45.

[131] *Id.* at 27–30.

[132] I.R.C. § 106.

[133] *Id.* § 408.

[134] *Id.* § 163.

[135] *Id.* §§ 167–168.

[136] *Id.* § 170.

[137] *See* Blum, *supra* note 9, at 251.

IV. COMPLEXITY TODAY

Complexity is inevitable in the tax system because the forces affecting the system all lead to complexity. As discussed *supra*, the scope of the tax system and its ability to tax over 313 million people[138] in the largest economy in the world,[139] the use of progressivity as a means to equity,[140] the constant desire to seek out and eliminate abuse,[141] and non-revenue raising uses of the tax system[142] all add to the system's complexity. These forces will continue to produce an increasingly complex system and, given their roots, these forces are likely to be prevalent in any tax system adopted in the United States.[143] While the system itself will never achieve complete simplicity due to the inevitable need for complexity in a complicated society, it does not mean that the system cannot be simplified or made fairer for the collective population. The system has to be complex to address the needs of taxpayers; however, in adding complexity to achieve equity, special attention has to be taken to ensure more equity is gained than lost.

A. The Need for Certainty and Fairness Outweigh the Benefits of Simplicity

1. The Benefits of Simplicity

Despite the inherent causes of complexity in the tax system, simplicity has always had a constituency.[144] Proponents of a simple system often state that complexity leads to ambiguity, creates opportunity for manipulation,[145] and lessens the likelihood that the IRS will catch noncompliance.[146] The proposed fix

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[138] U.S. Census Bureau, *State & County QuickFacts*, CENSUS.GOV, http://quickfacts.census.gov/qfd/states/00000.html (last updated Sept. 18, 2012, 4:41 PM).

[139] *See generally* CENTRAL INTELLIGENCE AGENCY, THE WORLD FACTBOOK 2011 (2011), *available at* https://www.cia.gov/library/publications/download/.

[140] *See supra* Part III.B.

[141] *See supra* Part III.C.

[142] *See supra* Part III.D.

[143] *See* Colliton, *supra* note 1, at 327 ("However much we complain about the complexity of the Code, the forces that govern the tax law require greater and greater complexity.").

[144] *See* Eichholz, *supra* note 7, at 1212 ("In this country we have heard strident complaints about the complexity of the income tax almost since its inception.").

[145] *See* THE STAFF OF THE JOINT COMMITTEE ON TAXATION, 107TH CONG. 1, STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986 109 (Comm. Print 2001) (indicating that complexity creates ambiguity, unintentional noncompliance, opportunities for manipulation, and can instill cynicism which can lead to intentional noncompliance); *Hearings*, *supra* note 45, at 1 ("Complexity begets more complexity, burden, and noncompliance, as it creates opportunities for abuse, which in turn spur more complex legislation that may alienate taxpayers.").

[146] THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 3, 56 ("The complexity of the system also makes it harder for the IRS to do its job by increasing the difficulty of identifying non-compliant and improper behavior. . . . Complex provisions also facilitate intentional

is generally a simpler and fairer system[147] in which compliance costs are almost completely avoided[148] due to the average American's newfound ability to do their own taxes.[149] Many proposals even suggest simplifying the system to a level that would allow taxpayers to file on a single sheet of paper[150] or in less time than it takes to do the morning crossword puzzle.[151] Proponents of simplicity also suggest that complexity causes frustration and doubt about the fairness of the tax system,[152] which in turn leads to noncompliance.[153]

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noncompliance (evasion) in part because they make it difficult for the IRS to determine whether a taxpayer is complying with the law absent a substantial and sophisticated audit."); McCaffery, *supra* note 9, at 1291 ("[C]omplexity makes it harder for the IRS to keep up its side of the tax lottery game, as it makes it more difficult for tax enforcers to know the laws and perform their duties. It also becomes harder for courts to understand the law well enough to ensure just results. Ultimately, more time is spent on learning the law and less on enforcing it."); Roberts et al., *supra* note 9, at 331 ("[T]he complexity of the law lessens the likelihood that an uncertain adverse consequence will be noticed, an opportunity that some clients take into account based on their own experience.").

[147] *See, e.g.*, JON HUNTSMAN FOR PRESIDENT, *supra* note 15, at 3; ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 37–47; The National Commission on Economic Growth and Tax Reform, *supra* note 93, at 417.

[148] *See* LAFFER ET AL., *supra* note 6, at 4; THE MOMENT OF TRUTH, *supra* note 14, at 29 ("Simplifying the code will dramatically reduce the cost and burden of tax preparation and compliance for individuals and corporations."); PERRY FOR PRESIDENT, *supra* note 15, at 3 ("[W]e must simplify the tax code so families and businesses are no longer wasting billions of hours and dollars each year just trying to comply with the mess that is the current tax code."); ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 38 ("Every year, individual taxpayers are forced to confront a Rube Goldberg contraption of bewildering complexity that leads to a range of undesirable outcomes, including the fact that millions of Americans have to pay hundreds of dollars to have their tax returns prepared by a professional who understands the rules.").

[149] *See* ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 43 ("Every American would be readily able to ascertain what they owed and why they owed it, and many forms of unproductive tax gamesmanship would be brought to an end."); Blum, *supra* note 9, at 253 (indicating that tax returns could be made considerably simpler if the Code were simpler).

[150] *See, e.g.*, PERRY FOR PRESIDENT, *supra* note 15, at 3–5; Newt 2012, *supra* note 15 (referring to an "optional flat tax of 15% that would allow Americans the freedom to choose to file their taxes on a postcard, saving hundreds of billions of unnecessary costs each year.").

[151] *See, e.g.*, The National Commission on Economic Growth and Tax Reform, *supra* note 93, at 422 ("With a simpler system, taxpayers will be able to file their returns on a single piece of paper in less time than it takes to finish your morning crossword puzzle.").

[152] *See* THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 3; U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 29, at 1 (indicating that complexity exacerbates doubts about the current tax system's fairness); *Hearings*, *supra* note 45, at 7 ("[C]omplexity encourages tax shelters and aggressive positions that reduce compliance, produce controversy, and waste both IRS and taxpayer resources, reducing respect for the tax system.").

[153] McCaffery, *supra* note 9, at 1290–91 (suggesting that complexity in a self-assessment, "tax lottery" system leads to dishonesty because complexity leads honest taxpayers to noncompliance, it drives out good practitioners in favor of the bad, and lowers the risk of a dishonest taxpayer being caught). There is no doubt that complexity causes some unintentional noncompliance, *Hearings*, *supra* note 45, at 36, and perhaps even some intentional noncompliance, THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 4, 56. However, in a self-reporting, audit lottery system there will always be some element of intentional and unintentional noncompliance. *See supra* Part III.

2. Broad Statutory Language Leads to Abuse, Noncompliance, and Long Periods of Inequity

To achieve the "simple" system discussed in recent tax proposals, the length of the Code would have to be significantly reduced and precise language would have to be replaced with broad and more easily understood language. If this is the path to simplicity, then certainty and fairness will be the cost to pay because broad statutory language opens the doors to abuse and leads to long periods of uncertainty.[154]

Certainty is a fundamental requirement of a fair tax system.[155] Not only are certain laws more difficult for both the government and taxpayers to manipulate,[156] but the Treasury needs certainty in its revenue stream and individuals need certainty for tax and business planning. "The more certainty taxpayers have about the law and the more predictable the law is from year to year, the easier it is for taxpayers to comply with the law and the less likely it is for taxpayers to make unintentional errors."[157] While certainty is necessary, it cannot be achieved through broad laws.

Broad laws lead to increased uncertainty and long periods of inequity.[158] With broad statutes and imprecise language, the task of filling in the detail is left to the courts and the Treasury. As courts interpret the law, the "simple" and easily understood words in the Code become complex because their meanings stem from judicial interpretation and can be understood only by reference to case law.[159] Unlike the Code and Treasury Regulations, case law is generally not applicable to everyone[160] and court interpretations often vary among the various United States Circuit Courts of Appeals. Increased use of the courts and broad standards provides the IRS with much more discretion and increases the likelihood of similarly situated taxpayers receiving different treatment. Increased use of the courts also puts a disproportionate burden on individual taxpayers who are legitimately trying to comply with the law but who have to bear the

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[154] *See* Eichholz, *supra* note 7, at 1200–11 (indicating that the benefits of simplicity can only be gained at the sacrifice of certainty and fairness).

[155] Professor Miller has stated that tax planners equate fairness with certainty because it is impossible to determine how to avoid an adverse consequence of the law until its application can be determined with reasonable certainty. *See* Miller, *supra* note 9, at 15. Professor Miller's approach fails to take into account that certainty is both needed and desired in the tax system. *See infra* text accompanying notes 158–60.

[156] *See* Donaldson, *supra* note 24, at 661.

[157] *See* THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 56.

[158] Blum, *supra* note 9, at 246.

[159] *See* Bittker, *supra* note 9, at 2.

[160] The United States Supreme Court being the exception.

cost of legal research by tax professionals or litigation due to uncertainty in the law's application. These costs can far outweigh the tax dollars involved in a controversy,[161] especially considering the uncertainty of a favorable result with broad laws.[162] With broad laws, taxpayers may still be able to seek a private letter ruling, but even paying the cost to obtain a private letter ruling may outweigh the cost of a specific tax benefit.

Increased use of the courts also elongates the time it takes to achieve the level of fairness that comes from complex statutes that explicitly address more known factual scenarios. As courts work to apply broad laws to specific factual scenarios, gaps in time exist where people with the best lawyers and accountants can circumvent the laws and take advantage of ambiguities. Taxpayers and their lawyers are eager to test the tax system in hopes of minimizing tax liability.[163] If taxpayers were willing to sit by silently and accept undesirable tax consequences, then the need to eliminate loopholes would be less pressing.[164] Taxpayers cannot, however, be expected to ignore the possibility of legally retaining more of their income, and lawyers cannot be asked to avoid finding ways to legally minimize their clients' tax liabilities. To do so would be like asking a plumber to work in bathrooms but not on toilets or a baker to bake cakes but not pies. If law firms, accounting firms, and investment banking firms are willing to scour a *complex* Code for ambiguities,[165] then they will certainly take the time to scour a *simple* Code with broad language for ambiguities and inconsistencies. As a result, simple, broad statutory language leads to the "loopholes" that everyone is so adamant about closing; not only can loopholes not be eliminated through simplicity, they are created by it.

The American public is constantly concerned with inequities in the system,[166] and they are not willing to wait for the courts to interpret tax law to root out inequity and provide certainty through interpretation of tax law. As such, the Treasury and taxpayers are constantly asking Congress to clarify the law.[167] Historically, this has resulted in a decrease in the role of the courts in interpreting

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[161] *See, e.g.*, Pevsner v. Comm'r, 628 F.2d 467 (5th Cir. 1980), *reh'g en banc denied* 636 F.2d 1106 (1981) (reversing a United States Tax Court decision permitting a $1,621.91 deduction for clothing).

[162] *See* Roberts, *supra* note 25, at 8.

[163] *See* Colliton, *supra* note 1, at 326.

[164] *See* Blum, *supra* note 9, at 246.

[165] *Hearings*, *supra* note 45, at 7 (indicating that sophisticated taxpayers who want to avoid their taxes may exploit complicated loopholes).

[166] *See supra* Part III.C.

[167] Colliton, *supra* note 1, at 326.

tax law and a shift to periodic amendments to the Code to provide certainty in the laws' application.[168]

Due to the elaborate process of enacting a tax law, many see the use of amendments over court interpretation as the preferred method of fixing problems in the tax system[169] because it is likely to produce more consistent results.[170] Congress is certainly in a better position to evaluate the benefits and burdens of changes to the Code,[171] and unlike most courts, Congress has the power to quickly implement change across the entire system.[172] The ability to make quick changes is necessary because new problems frequently arise as taxpayers test the rules and change their behavior in an attempt to get around the factual scenarios already addressed by the Code.[173] The use of amendments also results in a greater aggregate equity because the period of potential abuse is reduced and the litigation costs previously born by individual taxpayers seeking clarity are spread across the entire system. What result are complex statutes designed to eliminate abuse, anticipate and resolve future interpretative problems, address more and more factual scenarios, and still provide the intended benefits.[174] These rigid statutes provide certainty, which is not only desired,[175] but seen as a simplification of the overall tax system because it results in less administrative and judicial controversy.[176]

Abuse and noncompliance are major concerns because they affect the morality of the tax system and can lead to more noncompliance.[177] This being said, broad statutory language—not complexity—leads to more ambiguity and noncompliance in the tax system. Broad statutes lead to taxpayer abuse, increased judicial interpretation, long periods with gaps in the law, and they cause

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[168] Blum, *supra* note 9, at 245–46. Unlike in previous generations, legislation has a larger role today in shaping the Code than the judiciary. *See* Colliton, *supra* note 1, at 265–74.

[169] *See* Surrey, *supra* note 9, at 698.

[170] For a discussion of the political process and the role of Congress in tax law, see McDaniel, *supra* note 9, at 27–28; Roberts et al., *supra* note 9, at 351–60. It is important to note that courts have recognized that Congress is in a better position to resolve tax issues. *See* Comm'r v. Idaho Power Co., 418 U.S. 1, 19 (1974) (Douglas, J., dissenting) ("Indeed, we are called upon mostly to resolve conflicts between the circuits which more providently should go to the standing committee of the Congress for resolution.").

[171] *See* Gen. Motors Corp. v. Tracy, 519 U.S. 278, 309 (1997) ("Congress has the capacity to investigate and analyze facts beyond anything the Judiciary could match . . . .").

[172] *See* U.S. CONST. amend. XVI ("Congress shall have the power to lay and collect taxes on incomes, from whatever source derived . . . ."); Surrey, *supra* note 9, at 698.

[173] Blum, *supra* note 9, at 241, 246.

[174] *See* Colliton, *supra* note 1, at 268; Eichholz, *supra* note 7, at 1210.

[175] Surrey, *supra* note 9, at 697.

[176] *See* Blum, *supra* note 9, at 245.

[177] *See* Roberts et al., *supra* note 9, at 328.

individual taxpayers to bear the costs of litigating issues that Congress should solve. While there are often difficulties in keeping detailed statutes up to date,[178] the transparency and certainty provided by complex statutes allows taxpayers to make more informed decisions and better plan their financial lives.[179] If history is *any* indication, certainty will continue to be viewed as more important than simplicity, and Americans will continue to embrace sacrificing "simplicity" to achieve the stability and fairness that results from complexity.[180]

B. Technical Complexity in the Code is No Longer an Issue

It has been suggested that it is unfair for the Government to demand from taxpayers "the extra time and energy required to master unnecessary complexities."[181] This is true, but despite what some may think,[182] technical complexity in the Code is not always an unnecessary complexity.[183] Tax provisions may sound simple in general terms, but often can be expressed only in complex language when written to apply with certainty and to root out abuse mechanisms while still permitting intended uses.[184]

Technically complex language in the Code may not be as much of a problem for the average taxpayer today as it was in the past. Many of the recent tax proposals are concerned about the average American's ability to do his or her own taxes without having to pay a professional who "understands the rules."[185] What these proposals forget is that professionals understand the rules because, unlike most taxpayers, they read the rules. The text of the Code and judicial decisions are directed at the tax expert: the IRS, Treasury, tax attorney, and the like. "Congress does not write any statute, tax or otherwise, with the intention that every person

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[178] Surrey, *supra* note 9, at 698.

[179] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 29, at 47. It has been said that uncertainty from complexity comes in the form of delays in Treasury Regulations that are required to fully understand the law. It is true that the Treasury can be slow to issue regulations. *See* Andrea Monroe, *Too Big to Fail: The Problem of Partnership Allocations*, 30 VA. TAX REV. 465, 482–83 (2011); Andrea Monroe, *Saving Subchapter K: Substance, Shattered Ceilings, and the Problem of Contributed Property*, 74 BROOK. L. REV. 1381, 1412 (2009). However, the speed at which the Treasury issues regulations is not an issue solely reserved for complex statutes. Delays in Treasury Regulations also occur with "simple" laws, and such delays are presumably more problematic than with complex laws that are designed to address more known factual scenarios to begin with.

[180] *See* Schenk, *supra* note 9, at 123.

[181] Paul, *supra* note 9, at 286.

[182] *See* McCaffery, *supra* note 9, at 1284.

[183] *See* Blum, *supra* note 9, at 253; McCaffery, *supra* note 9, at 1276; Surrey, *supra* note 9, at 682; *supra* Part III.C.

[184] *See* Eichholz, *supra* note 7, at 1213.

[185] *See* ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 38; *accord* PERRY FOR PRESIDENT, *supra* note 15, at 3.

affected by the statute will read and comprehend it."[186] If that were the case, the Code would likely be longer than it is today[187] and there would not have to be a presumption that people know the law.[188] On the contrary, it is likely that most individual taxpayers have never seen Title 26 or the accompanying regulations.[189] It is also likely that no matter how simple the Code could be made, individuals and entities would still seek the advice of tax professionals.[190]

It used to be the case that people spoke of tax complexity *mostly* in terms of the "complexity of its substantive provisions,"[191] that is, the technical complexity of the Code. Technical complexity in the *Code* is not an issue for the average person today because it is not directed at, nor read by, the average person. Due to the prevalence of IRS publications, tax software, tax professionals, and tax clinics,[192] people today speak of tax complexity *mostly* in terms of the tax *system* as a whole. This is because the technical complexity faced by individual taxpayers likely comes from the items they use to prepare their taxes: tax software, tax instructions, tax forms, and IRS publications—not the Code.[193]

Many of the recent tax proposals focus on complexity in the Code; this focus is illogical because individual taxpayers do not generally interact with the Code. While IRS publications, instructions, and forms have to be detailed enough to

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[186] Donaldson, *supra* note 24, at 672.

[187] *Id.* at 675 (suggesting that tax laws written for the general populace would have to be written with more text, not less).

[188] *See* Blumenthal v. United States, 88 F.2d 522, 530 (8th Cir. 1937) ("It is elementary that everyone is presumed to know the law of the land, whether that be the common law or the statutory law . . . .").

[189] *See, e.g.*, Eichholz, *supra* note 7, at 1219–20; Schenk, *supra* note 9, at 127–28 ("[L]ow income taxpayers do not, as a rule, need to interpret the law.").

[190] *See* Eichholz, *supra* note 7, at 1220.

[191] *Id.* at 1204.

[192] *See* THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 3 (indicating that the IRS estimates that about sixty percent of taxpayers pay tax preparers to fill out their returns and twenty-six percent use tax software); *Hearings*, *supra* note 45, at 12 (indicating that twenty-nine percent of taxpayers use tax software).

[193] *See* Schenk, *supra* note 9, at 128 ("For many taxpayers, the tax return and instructions present a bewildering morass of rules which cannot be mastered easily."). The instructions accompanying Form 1040, for example, have grown exponentially over time, from a single page consisting of twenty bullet points in 1913, IRS, FORM 1040 (1913), *available at* http://www.irs.gov/pub/irs-prior/f1040--1913.pdf; to sixteen pages in 1951, IRS, HELPFUL INFORMATION ON HOW TO PREPARE YOUR U.S. INCOME TAX RETURN ON FORM 1040 FOR 1951 (1951), *available at* http://www.irs.gov/pub/irs-prior/i1040--1951.pdf; twenty-eight pages in 1971, IRS, 1971 INSTRUCTIONS FOR FORM 1040 AND FOR SCHEDULES A, B, C, D, E, F, AND R (1971), *available at* http://www.irs.gov/pub/irs-prior/i1040--1971.pdf; eighty pages in 1991, IRS, INSTRUCTIONS FOR 1040 AND SCHEDULES A, B, C, D, E, F, EIC, F, AND SE 1991 (1991), *available at* http://www.irs.gov/pub/irs-prior/i1040--1991.pdf; and 189 pages in 2011. IRS, 1040 INSTRUCTIONS INCLUDING INSTRUCTIONS FOR SCHEDULES A, C, D, E, F, J, R, AND SE 2011 (2011), *available at* http://www.irs.gov/pub/irs-prior/i1040--2011.pdf.

reflect tax laws, regulations, and judicial interpretations, they are directed toward the average taxpayer and efforts to reduce technical complexity should begin here. The publications, forms, and instructions provide a means of identifying unnecessary complexity—not a method of correcting it. Efforts to reduce complexity should begin with the publications and instructions because they provide a succinct overview of an area of law and can often bring unnecessary complexity in the system to light. For example, IRS Publication 970: Tax Benefits for Education provides that:

> [e]ven though the same term, such as qualified education expenses, is used to label a basic component of many of the education benefits, the same expenses are not necessarily allowed for each benefit. For example, the cost of room and board is a qualified education expense for the qualified tuition program, but not for the education savings bond program.[194]

A non-uniform definition of "qualified education expenses" is an unnecessary technical and structural complexity because it makes it significantly more difficult for taxpayers to understand and differentiate between the education provisions. Publication 970 cannot be changed to eliminate this unnecessary complexity because doing so would make the publication misleading and reduce its value to taxpayers. The publication can only be made less complex once the Code is made less complex. Still, the publications are a great place to find the unnecessary complexities in the Code.

V. A SIMPLER SYSTEM

A. The Alternatives

There are several viable ways to simplify the tax system; however, most are unlikely to be meaningfully implemented in the near future. Congress could significantly simplify the tax system, for example, by eliminating income tax; however, aside from Ron Paul, there is not much support for zero income tax.[195]

A more feasible alternative—and one with much more support—is to remove provisions from the Code.[196] Eliminating tax provisions will simplify the

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[194] IRS, PUBLICATION 970: TAX BENEFITS FOR EDUCATION 3 (2011), *available at* http://www.irs.gov/oub/irs-pdf/p970.pdf.

[195] Ron Paul wants to repeal the Sixteenth Amendment, abolish the income and estate tax, and have a "0% income tax rate for Americans." Ron Paul Presidential Campaign Committee, *supra* note 20.

[196] *See* ROMNEY FOR PRESIDENT, INC., *supra* note 15, at 41 (suggesting elimination of the federal estate tax because it creates a series of perverse incentives that encourage the most complicated and convoluted tax-avoidance schemes at tremendous cost to all involved); THE MOMENT OF TRUTH, *supra* note 14, at 31 (suggesting elimination of the AMT); Rick Santorum for President, *supra* note 15; Newt 2012, *supra* note 15 (suggesting elimination of the estate tax and AMT).

tax system because eliminating a tax provision also eliminates the complexities and potential loopholes that go along with it.[197] With this in mind, eliminating deductions or credits intended to account for material differences in taxpayers may result in horizontal inequity. Eliminating some provisions, such as the Alternative Minimum Tax (AMT), will result in reduced revenue collections. In either situation, a change in tax liability will likely result for a significant number of taxpayers.[198] To address this, Congress will have to either accept the increase or decrease in revenue or offset the change by adjusting marginal rates or adding or modifying other provisions. While eliminating provisions seems like a quick route to simplicity, to do so requires reduced revenue collections or counter measures to replace lost revenue and to re-balance the equities, and there is no guarantee that new marginal rates or replacement provisions will themselves be simple or fair.[199]

A third alternative to achieve simplicity is to stop using the tax system to promote social policy. This alternative also requires removing provisions—most notably tax expenditures—from the Code. Assuming, and it may be too much to do so, that the current tax expenditures and provisions were individually crafted based on specific and justifiable material differences in taxpayers that warrant differing treatment, then removing the expenditures will cause perceived inequities in the system. As proponents of simplicity often tout, perceived inequities in the system cause a distrust that can lead to noncompliance.[200] It is evident based on the large number of tax expenditures[201] that politicians prefer to avoid perceived inequity in the system. As such, it is unlikely that Congress will make a fundamental movement away from using the tax system to promote social policy.

A fourth alternative to achieve simplicity is to move away from progressivity and adopt a flat tax. Replacing the current marginal rates with a flat rate would not result in much simplicity because the marginal rates add little complexity to the system. To achieve simplicity, the flat tax would have to apply to a comprehensive

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[197] *See, e.g.*, Paul, *supra* note 9, at 288–89.

[198] Removal of provisions will not always affect a significant number of Taxpayers. For example, the estate tax is only paid by about 15,000 estates annually, so eliminating the estate tax would only affect a relatively small number of taxpayers. *See* IRS, STATISTICS OF INCOME: ESTATE TAX STATISTICS (2012), *available at* http://www.irs.gov/pub/irs-soc/10esesttaxsnap.pdf. That being said, removing the estate tax would result in a thirteen billion dollar reduction in tax revenue. *Id.*

[199] *See* Blum, *supra* note 9, at 245 (indicating that there is no guarantee that a replacement provision, if there were one, would result in a simplification of the Code, and there is no guarantee that it would not shift the tax burden in an unfair way).

[200] *See* Roberts et al., *supra* note 9, at 328.

[201] *See* THE 2012 REPORT, *supra* note 128, at 32–45.

tax base and tax expenditures would have to be eliminated.[202] This, of course, is easier said than done, and, as previously indicated, it is unlikely to happen given the extent to which progressivity and non-revenue raising uses of the Code penetrate the system.[203]

These alternatives are not the only ways to simplify the tax system, and they are not independent of each other. While a significant move away from progressivity and non-revenue raising uses of the tax system is unlikely, that does not mean that they cannot be lessened.

B. The Proposed Solution

It is a premise of this article that the United States' tax *system* will always be complex because the forces behind the system all lead to complexity. Because these forces would also be present in any "new" tax system that might result from sweeping reform, the best reform would take the form of a systematic elimination of inequities and unnecessary complexities in individual Code sections and in the application of individual Code sections, taking into account how the provisions interact with the rest of the Code. By focusing on the actual and perceived inequities and unnecessary complexities, this approach is able to provide the fairness sought by recent reform proposals,[204] and it will avoid the possibility of having long periods of inequity that may result from enacting broad statutes.[205]

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[202] *See* PERRY FOR PRESIDENT, *supra* note 15, at 3–5 (proposing an optional flat tax that could be filed on a postcard); Newt 2012, *supra* note 15 (referring to an "optional flat tax of 15% that would allow Americans the freedom to choose to file their taxes on a postcard, saving hundreds of billions of unnecessary costs each year").

[203] *See supra* Parts III.B & D.

[204] *See, e.g.*, Barack Obama, The 2012 State of the Union: An America Built to Last (Jan. 24, 2012), *available at* http://www.whitehouse.gov/photos-and-video/video/2012/01/25/2012-state-union-address-enhanced-version#transcript ("Right now, because of loopholes and shelters in the tax code, a quarter of all millionaires pay lower tax rates than millions of middle-class households. Right now, Warren Buffett pays a lower tax rate than his secretary."). One cannot help but note that "President Obama and first lady Michelle Obama had a combined income of $789,674 in 2011 but paid a lower tax rate [than] the President's secretary, who made less than $100,000." *Obama Paid a Lower Tax Rate Than His Secretary*, FOXNEWS.COM (Apr. 13, 2012), http://nation.foxnews.com/president-obama/2012/04/13/obama-paid-lower-tax-rate-his-secretary.

[205] *See supra* Part IV.A. A second possible solution, which could take place concurrently with the systematic elimination of unnecessary complexity in the system, is to move to a system in which the IRS pre-prepares returns for taxpayers who meet certain criteria (The IRS could only pre-prepare returns because section 6065 requires taxpayers to sign income tax returns under penalties of perjury.) This would eliminate nearly all complexity for the taxpayers who qualify, and some have estimated that the IRS could pre-prepare returns for "up to 40 percent of all U.S. taxpayers." THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 42. The result would be a savings of "hundreds of millions of hours and billions of dollars in preparation fees, while actually reducing the cost to the IRS of administering the tax system by reducing errors and resultant investigations." *Id.* It has also been suggested that a program such as this could "reasonably be expanded to as many as 60 million taxpayers—about half of the total number—who have third-party reported income and who did not itemize deductions." *Id.* at 43.

C. The Solution Applied: The Education Credits and Form 1098-T

The United States tax system will always be complex; however, when complexity does not add equity or an intended societal benefit to the system,[206] it is unnecessary and should be systematically eliminated. Efforts to reduce complexity in the Instructions to Form 1040 and IRS publications will likely shed light on areas of the tax system that are unnecessarily complex and in need of simplification. For example, the Code has at least eighteen different provisions designed to encourage education,[207] and twelve such provisions are explained over eighty-six pages in IRS Publication 970.[208] While students across the country no doubt appreciate receiving the tax benefits associated with education, the options can be daunting. There are deductions,[209] exclusions,[210] and credits,[211] and taxpayers often have to make multiple calculations to determine what provisions will provide the largest benefits. Considering that the American Opportunity Credit[212] and Lifetime Learning Credit[213] are claimed by over four million taxpayers per year[214] and account for an annual estimated tax expenditure of nine billion dollars,[215] the education provisions are certainly the type of "mass" provisions that lend themselves to simplification.[216]

Congress could eliminate one area of unnecessary complexity by adopting a uniform definition of qualified education expenses for purposes of the various education tax incentives,[217] qualified state tuition programs,[218] and education IRAs.[219] It is an unnecessary technical and structural complexity for the same term to mean different things in different contexts. It is also an unnecessary compliance complexity to require taxpayers, who may already be reading an eighty-six page

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[206] *See* McCaffery, *supra* note 9, at 1287–89 (indicating that complexity does not always add equity).

[207] THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 10–13.

[208] *See* IRS, PUBLICATION 970: TAX BENEFITS FOR EDUCATION (2011), *available at* http://www.irs.gov/oub/irs-pdf/p970.pdf.

[209] I.R.C. §§ 221–222.

[210] *Id.* §§ 117, 529–530.

[211] *Id.* § 25A.

[212] *See id.*

[213] *See id.*

[214] *See* IRS, SOI TAX STATS – INDIVIDUAL TAX RETURNS COMPLETE YEAR DATA TABLE 2 (2009), *available at* http://www.irs.gov/pub/irs-soi/11infallbulincome.pdf.

[215] *See* THE 2012 REPORT, *supra* note 130, at 41–42.

[216] *See* Bittker, *supra* note 9, at 5 (suggesting that efforts for simplicity should be focused on the "mass" provisions affecting millions of taxpayers).

[217] *See* I.R.C. §§ 25A, 222.

[218] *See id.* § 529.

[219] *See id.* § 530.

document to determine if and what education tax benefits they qualify for, to have to apply the same term differently among the twelve listed potential benefits.[220] Disparities such as this add unnecessary complexity to the tax system and, yet, they are prevalent throughout the education provisions.[221] Given the unnecessary structural, technical, and compliance complexities in the education provisions, it is no wonder that "19 percent of eligible tax filers in 2005 did not claim either a tuition deduction or a[n education] tax credit that could have reduced tax liability by an average of $219."[222]

While an overall solution to eliminating unnecessary complexity in the education provisions is beyond the scope of this article, a discussion of the unnecessary complexity associated with the American Opportunity Credit, Lifetime Learning Credit, and Form 1098-T is illustrative of both the problems and potential solutions. The American Opportunity Credit and the Lifetime Learning Credit each provide a credit based on "qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished during any academic period beginning in such taxable year)."[223] Both credits also *require* that "qualified tuition and related expenses . . . paid by the taxpayer during a taxable year for an academic period which begins during the first 3 months following such taxable year" be treated as if they occurred during the taxable year.[224] Essentially, this means that when tuition for classes starting in January is paid prior to the start of the new year, the taxpayer is required to treat the amount paid as if it occurred in the prior taxable year.

Requiring prepaid tuition to be treated as if it occurred during the taxable year paid is an unnecessary structural and technical complexity because it distorts reality and allows educational institutions—who set tuition due dates and apply loan funds—to significantly affect the credits students are entitled to. Educational institutions that require prepayment of tuition, for example, will increase students' qualified tuition in the first year of their education and reduce or eliminate qualified tuition in the last year. This can have the positive effect of moving a portion of a student's tax credit to an earlier year, but it can also have the negative effect of eliminating qualified tuition and the corresponding credit for a student's final year of education. Students that are not required to prepay tuition have

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[220] *See* IRS, PUBLICATION 970: TAX BENEFITS FOR EDUCATION 3 (2011), *available at* http://www.irs.gov/oub/irs-pdf/p970.pdf (indicating that the term "qualified education expenses" has several different meanings).

[221] For example, is there a legitimate justification for allowing taxpayers with a felony drug conviction to receive the Lifetime Learning Credit but not the American Opportunity Credit? *See* I.R.C. § 25A(b)(2)(D).

[222] THE PRESIDENT'S ECONOMIC RECOVERY ADVISORY BOARD, *supra* note 2, at 13.

[223] *See* I.R.C. § 25A.

[224] *See id.* § 25A(g)(4).

more control and flexibility in allocating their education expenses to different tax years; however, much of that control is lost for students who pay tuition with loan money because educational institutions control loan distributions.[225]

By requiring taxpayers to treat prepaid tuition as if it occurred in the taxable year in which it was paid, the Code gives educational institutions the power to control students' education tax credits. This is likely an unintended consequence of the provision and it causes inequity in the tax system because it produces inconsistent results. Horizontal inequity results because similarly situated college students receive different education credits based not on their actions, but on what system educational institutions use to collect tuition. This unnecessary structural complexity causes confusion and noncompliance because taxpayers have little or no say as to prepaying tuition and students often transfer between schools with differing policies on tuition payments.

The unnecessary complexity and inequity that results from requiring prepaid tuition to be treated as if it occurred during the taxable year in which it was paid can be easily avoided by changing one word in the Code. If "shall" is changed to "may" in section 25A(g)(4), then students will have the option to include prepaid tuition in the tax year in which it is paid or in which the classes are taken. This will take power away from educational institutions, allow students to impact what education credits they are entitled to, and significantly reduce noncompliance.

The unnecessary compliance complexity associated with the education credits has been further complicated by Form 1098-T.[226] Form 1098-T permits

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[225] Considering that "[s]tudents are borrowing more money to pay for college than ever before," the number of students who are able to prepay their tuition is likely very low. Larry Abramson, *College Students' Borrowing Hits an All-Time High*, NPR (Nov. 3, 2011), http://www.npr.org/2011/11/03/141951756/college-student-borrowing-hits-an-all-time-high.

[226] IRS, FORM 1098-T: TUITION STATEMENT (2012):

☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number		1 Payments received for qualified tuition and related expenses $	OMB No. 1545-1574 2012 Form 1098-T	Tuition Statement
		2 Amounts billed for qualified tuition and related expenses $		
FILER'S federal identification no.	STUDENT'S social security number	3 If this box is checked, your educational institution has changed its reporting method for 2012 ☐		Copy B For Student
STUDENT'S name		4 Adjustments made for a prior year $	5 Scholarships or grants $	This is important tax information and is being furnished to the Internal Revenue Service.
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year $	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2013 ▶ ☐	
City, state, and ZIP code				
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student ☐	9 Checked if a graduate student . . . . ☐	10 Ins. contract reimb./refund $	

Form 1098-T (keep for your records) Department of the Treasury - Internal Revenue Service

eligible educational institutions to report either "payments received" in Box 1 or "amounts billed" in Box 2 "for qualified tuition and related expenses."[227] Educational institutions also have the option, using Box 7, to include or not include amounts for an academic period beginning in the first three months following the taxable year.[228] Permitting educational institutions to report the amount billed rather than the amount actually paid adds significant compliance complexity to the tax system. Individual taxpayers generally report income and expenses for tax purposes on a cash basis, so it is hard to see the benefit of permitting educational institutions to report the "amount billed." A cash basis taxpayer that receives a Form 1098-T with Box 7 checked (indicating the educational institution reported amounts for the year following the tax year) and an amount billed listed in Box 2 has to determine the amount of qualified tuition and related expenses actually paid during the tax year. For the taxpayer to convert the "amount billed" in Box 2 into an "amount paid," she has to determine the number of credit hours taken in each quarter or semester of the year, the cost of those credit hours (keeping in mind that tuition often changes during the tax year), and the date that any scholarship or loan money was received by the educational institution. This is an unnecessary compliance complexity that is most easily born by educational institutions because they already have the information. The educational institutions set tuition cost and apply scholarships and loan funds, so it only makes sense to have the record keeping burden fall on them. In addition, there are significantly fewer educational institutions than individuals who receive a 1098-T, so shifting the compliance burden to the educational institutions would reduce the aggregate cost of compliance in the tax system.

Permitting educational institutions to report the amount billed also adds compliance complexity for the educational institutions. Educational institutions are required to track amounts received, amounts due, or amounts earned for accounting and tax purposes. The amount billed is different from all three of these accounting and tax triggers, so educational institutions that choose to report an amount billed take on the increased compliance complexity of having to track additional data. It is hard to see what—if any—benefit educational institutions receive from being able to report the amount billed for qualified tuition because doing so increases their compliance costs.

The current method of reporting leads to noncompliance. Many taxpayers think the amount listed in Box 2 on the Form 1098-T is the correct amount of "qualified tuition" that should be used in calculating the education credits. Those students who do not prepay their tuition and who use Box 2 in calculating an education credit will often take a higher education credit than they are allowed.

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[227] *See* IRS, INSTRUCTIONS FOR FORMS 1098-E AND 1098-T (2012), *available at* http://www.irs.gov/pub/irs-pdf/i1098et.pdf.

[228] *See id.*

This occurs when, for example, a first year law student who only attends school during the latter half of the tax year uses the amount listed in Box 2 on the 1098-T to calculate an education credit. Educational institutions generally apply scholarships at the beginning of academic periods, so the student's 1098-T would report the entire academic year's tuition and only half of the student's scholarship money received for the same period (because scholarships for the academic period beginning in January would not generally be received during the taxable year). Since the qualified tuition in Box 2 is not offset by the entire academic year's scholarships, a student using the amount in Box 2 will claim a larger credit than she is allowed. The effect of this is to shift a portion of the education credit that the student should receive in the final year of their schooling to an earlier tax year. If the student continues to report the qualified tuition as it appears on the 1098-T, then she will have reported all of her qualified tuition in the tax year prior to the tax year in which she finishes her education. Accordingly, the last 1098-T received from the educational institution will have a scholarship listed in Box 5 that cannot legitimately be offset by qualified tuition because all of the tuition would have already been accounted for in previous tax years. The taxpayer's only option then is to amend numerous tax returns, report the scholarship as income,[229] or do nothing. The latter option is presumably the most common option taken given the complexity and burden of amending multiple tax returns, the adverse consequence of reporting a scholarship as income, and the student's likely ignorance to the problem in the first place.

There are other outcomes as well. Take a taxpayer who enrolls for one year of law school and then drops out to start a business or a full-time L.L.M. student who graduates in one academic year. In either case, the taxpayer may have $10,000 of qualified tuition for the first semester, which is paid in the latter portion of the taxable year, and $10,000 of qualified tuition in the second semester, which is paid in the first portion of the tax year following the taxable year. If the student did not prepay their second semester tuition and they use the amount in Box 2 to calculate their education credit (assuming Box 7 is checked), then the taxpayer would report a Lifetime Learning Credit of $2,000 during the first tax year and zero dollars for the second tax year.[230] This results because the educational

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[229] Section 117(a) provides that "[g]ross income does not include any amount received as qualified scholarship by an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii)." I.R.C. §117(a). It may seem from first glance that a taxpayer in this situation would not have to report the scholarship as income; however, section 117(b)(1) provides that a scholarship is only a "qualified scholarship" if the individual can establish that "such amount was used for qualified tuition and related expenses." The student in this example over-reported qualified tuition and related expenses in previous tax years, so there will be no unreported qualified tuition and related expenses for the scholarship to be matched to. This inability to match the scholarship to qualified tuition and related expenses requires a student who does not amend the previous tax returns to report the scholarship money as income.

[230] *See id.* § 25A(c).

institution will list all qualified tuition for the academic year on the first year's Form 1098-T and no qualified tuition on the second year's Form 1098-T. Unlike the previous example, this type of noncompliance is to the taxpayer's detriment; a student who understands that Box 2 does not report qualified tuition for the taxable year will report a Lifetime Learning Credit of $2,000 for both the first and second tax year, not just the first year.[231]

Noncompliance based on incorrectly reporting the amount listed in Box 2 as "qualified tuition" is prevalent and can be easily avoided by removing Box 2 from Form 1098-T. The use of Box 2 to report qualified tuition results in an unintended result—some taxpayers get the relief intended, some intentionally or unintentionally get more or less than what is intended, and everyone pays the price of added compliance complexity. Any benefit received by educational institutions in reporting amounts billed for qualified tuition in Box 2 instead of the qualified tuition actually received in Box 1 are far outweighed by the unnecessary compliance complexity that results. To avoid this unnecessary complexity and the resulting noncompliance, Box 2 should be removed from Form 1098-T and educational institutions should be required to report qualified tuition actually paid by students. In addition, to avoid taxpayer confusion and the problems that can arise when students transfer between schools with different reporting methods, all educational institutions should be required to check Box 7 and report amounts received for academic periods beginning in the first three months following the taxable year.[232] Consistent reporting by educational institutions will reduce taxpayer confusion and the noncompliance that results from confusion.

VI. CONCLUSION

Death and taxes are the only two things guaranteed in life,[233] so naturally people try to avoid and postpone both. What results with respect to taxes is a system in which ambiguity and inconsistency in the law are sought out in an attempt to pay less tax. This is when the general notions of fairness kick in and taxpayers and the Treasury request that Congress amend the tax laws to avoid perceived inequities.[234] The amendments to eliminate abusive devises have to be intricate enough to root out improper uses of the Code and still permit

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[231] *See id.*

[232] It would also be acceptable if all educational institutions did not use Box 7. Taxpayer confusion and the resulting noncompliance will be reduced by having all 1098-Ts reflect the same reporting method, regardless of whether that method does or does not use Box 7.

[233] *See* Yablon, *supra* note 21, at 236 (quoting Benjamin Franklin as saying: "Our Constitution is in actual operation; everything appears to promise that it will last; but nothing in this world is certain but death and taxes").

[234] *See* Bittker, *supra* note 9, at 11 (indicating that the goal is a rule for every conceivable set of circumstances to minimize abuse, promote fairness, and add certainty).

the intended uses. What results is a frequently changing tax system with a predisposition toward eliminating ambiguity and inconsistency with detailed, complex statutory amendments. This cycle of abuse followed by the systematic elimination of loopholes is but one force adding complexity to the tax system.

The scope of the system, progressivity, and non-revenue raising uses of the system all add complexity to the system. Despite recent proposals to completely overhaul the system in favor of a "fair and simple" tax system, the forces adding complexity are so deeply rooted in American history that they will continue to be at play no matter what system is implemented. This will be especially true so long as Americans find it important to differentiate tax based on perceived material differences in taxpayers, because doing so promotes income avoidance techniques that can only be dealt with by adding complexity to the tax system.

It has been said that "simplicity is like a lighthouse: everyone can attest to its value, but no one will pay the price voluntarily."[235] This is especially true considering the need for certainty in a complex society.[236] As Justice Jackson stated with regard to tax law in *Dobson v. Commissioner* in 1943, "[n]o other branch of the law touches human activities at so many points. It can never be made simple, but we can try to avoid making it needlessly complex."[237] This is why, contrary to those seeking sweeping reform to "simplify" the tax system, the best reform will come in the form of the systematic elimination of inequity and unnecessary complexity in individual Code sections—and their application—taking into account how the provisions interact with the rest of the Code. This method of reform will not result in significantly less technical complexity.[238] It will, however, avoid the uncertainty that results from broad statutory language, and it will reduce the possibility of having long periods of inequity. Complexity is inevitable, but not all complexity is necessary. To achieve a greater aggregate equity in the system, a systematic effort to identify and eliminate *unnecessary* complexity needs to be undertaken.

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[235] *Id.*

[236] *See* Roberts, *supra* note 25, at 22.

[237] Dobson v. Comm'r, 320 U.S. 489, 494–95 (1943).

[238] It is important to note that the language of the Code—its technical complexity—does not lend itself to simplification and is likely only going to get more complex. *See* Colliton, *supra* note 1, at 328; Eichholz, *supra* note 7, at 1204.