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ADDRESSING IMPERFECTIONS IN THE TAX SYSTEM: PROCEDURAL OR SUBSTANTIVE REFORM?

Leandra Lederman and Stephen W. Mazza***

PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH — AND CHEAT EVERYBODY ELSE. By *David Cay Johnston*. New York: Penguin Group Inc. 2003. Pp. iii, 338. $25.95.

I. INTRODUCTION

Books about tax administration tend to fall into one of two broad categories: those that paint the Internal Revenue Service ("IRS") as an agency peopled by corrupt, out-of-control bureaucrats who take pleasure in seeing innocent taxpayers suffer,[1] and those that tell readers how to structure their affairs to minimize the risk of incurring an IRS employee's wrath during a tax audit.[2] *Perfectly Legal*, the full

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1. *See, e.g.*, SHELLEY L. DAVIS, UNBRIDLED POWER: INSIDE THE SECRET CULTURE OF THE IRS (1997) (describing the author's experiences as an IRS historian and the charges of ethical and legal violations on the part of IRS employees that she made during her tenure); WILLIAM V. ROTH, JR. & WILLIAM H. NIXON, THE POWER TO DESTROY 14 (1999) (describing the IRS as an agency with "unchecked power" and having a "culture of isolation that protects against interference and oversight"); RICHARD YANCEY, CONFESSIONS OF A TAX COLLECTOR: ONE MAN'S TOUR OF DUTY INSIDE THE IRS (2004) (recounting the author's experiences as an IRS collection agent and the misconduct and abuse allegedly carried out by fellow IRS employees). *But cf.* DONALD L. BARLETT & JAMES B. STEELE, THE GREAT AMERICAN TAX DODGE: HOW SPIRALING FRAUD AND AVOIDANCE ARE KILLING FAIRNESS, DESTROYING THE INCOME TAX, AND COSTING YOU (2000) (discussing the rise in tax evasion and Congress's role in limiting IRS enforcement of the tax laws).

2. *See, e.g.*, AMIR D. ACZEL, HOW TO BEAT THE I.R.S. AT ITS OWN GAME (2d ed. 1995); FREDERICK W. DAILY, STAND UP TO THE IRS (6th ed. 2001); ARNOLD S. GOLDSTEIN, HOW TO SETTLE WITH THE IRS... FOR PENNIES ON THE DOLLAR (2d ed.

title of which communicates David Cay Johnston's intent to focus on the tax system, does neither of those things. Instead, it is a book much like *The Great American Tax Dodge*,[3] which explained the many varieties of tax fraud; the difficulties the IRS faces in pursuing high-income individuals; the influence the affluent have on lawmaking; and Congress's success in tying the hands of the IRS.

In its strongest chapters, *Perfectly Legal* examines the inner workings of the IRS and describes the agency in a very different way from that represented in the popular press. While other authors may decry the threat of overzealous IRS agents, Johnston laments the inability of IRS employees to pursue known acts of noncompliance because of resource limitations and political pressures. While other authors may complain about the complexity of the Internal Revenue Code, leaving readers with the impression that the IRS is responsible for its enactment, Johnston lays blame for this complexity squarely where it belongs — with Congress and executive branch policymakers.[4]

Johnston's coverage of tax issues as an investigative reporter for the *New York Times* won him a Pulitzer Prize in 2001. Although many of Johnston's articles focus on complex issues of tax policy and administration — such as the restructuring of the IRS or efforts to repeal the estate tax — he, unlike most other journalists who attempt to tackle tax issues in the general press, is able to explain these difficult concepts in a thorough and engaging manner. Johnston's exposés, particularly those relating to the growth of the tax shelter industry in recent years, illustrate his formidable investigatory skills. While IRS officials may not be willing to admit as much, his articles apparently have brought to light a number of tax dodges that, if not for his reports, might still be hidden from government regulators.[5]

As its prologue suggests, *Perfectly Legal* draws in part on stories Johnston published in the *New York Times*.[6] The prologue explains

1997); MARTIN S. KAPLAN, WHAT THE IRS DOESN'T WANT YOU TO KNOW: A CPA REVEALS THE TRICKS OF THE TRADE (9th ed. 2004). Even this category of books sometimes cannot help but take aim at the IRS. *See* KAPLAN, *supra*, at 6 (describing the "long, powerful, and often ruthless and arbitrary arm of the IRS").

3. BARLETT & STEELE, *supra* note 1. Unlike *The Great American Tax Dodge*, *Perfectly Legal* does not focus only on tax issues. *See infra* text accompanying notes 6-7.

4. For a similar approach, *see* BARLETT & STEELE, *supra* note 1.

5. *See* David Cay Johnston, *U.S. Accuses 2 Audit Firms of Assisting Tax Violations*, N.Y. TIMES, July 10, 2002, at C1 (reporting that the IRS learned of tax shelters marketed by accounting firm KPMG from an article in the *New York Times*).

6. For example, as discussed below, Johnston recounts in *Perfectly Legal* the situation of David and Margaret Klaassen, a couple surprised to be hit by the alternative minimum tax. *See infra* text accompanying notes 36-41. Portions of Johnston's discussion of the Klaassens originally appeared in the *New York Times*. *See* David Cay Johnston, *Funny, They Don't Look Like Fat Cats*, N.Y. TIMES, Jan. 10, 1999, § 3, at 1.

that Johnston's initial goal in covering taxes was "to launch a running investigation" of the tax system (p. 1). Many of the chapters of *Perfectly Legal* do not discuss tax issues, however. Instead, they criticize such things as an increase in income inequality over the past thirty or so years and a tendency Johnston finds on the part of large corporations to prioritize compensating their key executives while disregarding the needs of the rank-and-file workers. Johnston claims that, because "there is no free lunch," the super rich "leave part of their bill on your table" (p. 11). According to Johnston, politicians and their campaign contributors are behind this trend, though the connection is not always made explicit.[7] The tax system is but one piece of the dark picture Johnston's completed puzzle depicts.

The chapters that do focus on taxation discuss issues that range from the specific and technical to larger issues of IRS enforcement. The theme that implicitly ties together Johnston's complaints about growing income inequality, the priorities of large corporations, decreasing progressivity in the federal tax system, and Congress's "handcuff[ing of] the tax police" (p. 150) is that low-income and middle-income individuals are fighting just to survive, while the well-to-do are doing better and better. In fact, much of *Perfectly Legal* is comprised of narratives about particular individuals, some of whom appear to represent, for Johnston, an entire class of people, such as the working poor, the middle class, or "the political donor class."

Given the broad range of topics that *Perfectly Legal* covers, it is unfortunate that it is not divided into parts. Some chapters are clearly connected to chapters they precede or follow while others essentially stand alone. As the next Part of this Review suggests, the first half of *Perfectly Legal* is particularly disjointed; it addresses a variety of seemingly unconnected issues, ranging from demographic trends to public disclosure of executive compensation to specific tax loopholes. Following that description of the book in Part II, Part III of this

7. The tax theme expressed in the prologue, which reappears periodically in the rest of the book, is that "our tax system now levies the poor, the middle class and even the upper middle class to subsidize the rich ...." P. 2. When comparing relative tax burdens, Johnston's focus, though generally not explicit, is the percentage of their income particular classes of individuals pay in taxes, not the absolute amount of taxes they pay. Thus, one of his principal claims is that lower-income individuals are taxed at a higher rate than higher-income individuals — in other words, that the combined federal income tax/social security system, in practice, is regressive:

> [W]hen all federal taxes are considered — from those on gasoline and beer to Social Security taxes as well as income and estate taxes — the [richest] 1 percent's share drops to about a fourth of the total tax bill.... If you tally up the economic benefits of the top 1 percent that do not show up in income statistics ... then the richest 1 percent are taxed more lightly than the middle class. The same data show that the poor are taxed almost as heavily as the rich are — and even more heavily than the super rich.

P. 11.

Review provides further critique and Part IV suggests a line of inquiry for future analysis of tax administration.

II. THE BOOK'S STRUCTURE AND PRINCIPAL ARGUMENTS

Perfectly Legal begins by introducing Jonathan Blattmachr, an attorney who specializes in finding loopholes that enable the wealthy to save taxes. The purpose the story serves in the book can be summarized in a statement Johnston attributes to Blattmachr: "The U.S. tax code is the most political law in the world" (p. 9). Chapter One also serves as an introduction to some of the topics discussed in later chapters, such as a number of tax compliance issues, including marketed tax shelters, corporate inversions, and difficulties in detecting certain types of tax evasion, as well as IRS reform resulting from Senate Finance Committee hearings in 1997 and 1998 (pp. 11-14). It also introduces Johnston's underlying theme that wealth concentration in the United States is partly due to a tax system that taxes the "super rich" more lightly than others (p. 11).

Johnston connects that claim with the notion that the super rich can hire attorneys like Mr. Blattmachr to develop strategies under which money can change hands "without showing up in the official statistics on wealth and income" (p. 11). Not only that, but super-rich individuals have more opportunities to evade taxes because they generally are not wage earners and receive less income subject to information reporting; "their friends in Congress have slashed budgets for inspecting the tax returns of the rich and super rich"; and, if they own businesses, they can live subsidized lifestyles by charging some of their expenses to their businesses (p. 13). Johnston argues, "[s]ince at least 1983 it has been the explicit, but unstated, policy in Washington to let the richest Americans pay a smaller portion of their incomes in taxes and to defer more of their taxes . . . while collecting more in taxes from those in the middle class" (p. 18).

After the first chapter, Johnston turns to a discussion of demographic trends, focusing primarily on changes in the U.S. economy in the last thirty to thirty-five years. His principal point is that, once earnings are adjusted for inflation, the salaries of most Americans have remained relatively flat while "the incomes of those at the very top soared" (p. 29), resulting in increased income inequality.[8] Johnston also discusses a trend over the same thirty or so years towards lower top income tax brackets and increased government reliance on Social Security revenue, which, because of its

8. In his discussion of an increase in average house size, Johnston points out that the home mortgage interest deduction provides a bigger subsidy for higher-income individuals and those who buy bigger houses. Pp. 21-22.

wage-base cap and lack of zero bracket, disproportionately burdens low-income individuals (p. 41).

Johnston connects growing income inequality with increased compensation for managers of large corporations. This created a demand for corporate tax shelters to keep profits high, "which helped shift the overall tax burden off capital and onto labor" (p. 41). Johnston blames Congress and other "lawmakers" for funneling benefits to "Corporate America" by allowing the demise of personal liability for the acts of other partners in a firm,[9] facilitating the "spread of 401(k) plans,"[10] and "attacking" the IRS.[11]

Johnston also includes a chapter on executive compensation, where he begins a discussion of stock compensation with a story about Robert Goizueta (pp. 45-47), Coca-Cola's one-time CEO. Here, Johnston's focus is on compensation arrangements that allow a small group of high-level executives to defer reporting a large portion of their compensation until future years (p. 47). According to Johnston, these "secret" arrangements are significant because they contribute to the "economic pain felt by millions of workers whose compensation was squeezed so that the top executives could take a larger share of the [corporation's] compensation budget" (p. 47). Johnston also argues that because a company cannot deduct deferred compensation,

9. P. 42. Johnston does not mention what law he is referring to when he states that "lawmakers encouraged these corporate [accounting] scandals [such as those involving Enron and Global Crossing] by ending a single legal principle — the policy that each partner in an accounting or law firm was liable for the acts of every other partner." *Id.* It is unclear whether this reference to lawmakers refers to members of Congress or state legislators. *See id.* Earlier in the same paragraph, Johnston refers to "lawmakers — often passing bills they had not read (some of which came to the floor of the House or the Senate without a single public hearing)," and the prior paragraph discusses the U.S. Congress. *Id.* Later in the book, Johnston refers to the limited liability partnership ("LLP") as the "structure [that] destroys the self-policing mechanism that helps to keep legal and accounting firms from using their enormous power to the detriment of others" because the LLP eliminates personal liability for the acts of other partners. Pp. 258-59. Johnston points out that the Texas legislature passed the first limited liability partnership law. P. 259; *see also* Larry E. Ribstein, *The New Choice of Entity for Entrepreneurs*, 26 CAP. U. L. REV. 325, 328 (1997). Johnston also states that it was the IRS that ruled in 1988 that a professional firm could be organized as a LLP. P. 259. The IRS did rule in 1988 that a Wyoming limited liability company could be taxed as a partnership, *see* Rev. Rul. 88-76, 1988-2 C.B. 360, but that ruling does not address LLPs or professional firms. In 1992, the IRS issued a letter ruling upholding partnership taxation for a Texas LLP. Priv. Ltr. Rul. 92-29-016 (Apr. 16, 1992).

10. P. 42. Johnston also criticizes a "federal law that requires companies to put too little money away in pension plans for younger workers." *Id.* Here, as elsewhere, Johnston does not state which law he is referencing. It appears from an article he published in 1995, David Cay Johnston, *The Fading Pension*, N.Y. TIMES, May 4, 1995, at D1, that he may be referring to changes enacted in 1994 as part of the Uruguay Round Agreements Act. *See* Pub. L. No. 103-465, § 761, 108 Stat. 4809, 5024-34 (1994).

11. Pp. 42-43. Here, Johnston is referring to the highly publicized 1997 and 1998 Congressional hearings on IRS reform. *See infra* text accompanying notes 17-18.

it raises the company's tax bill and is, therefore, "very expensive for shareholders, rank-and-file workers, and taxpayers" (p. 48).

The theme of corporate excess and its tax cost continues with a chapter focusing on the valuation of company-provided personal air travel. Johnston points out that the valuation rules often have made it less expensive for an executive to fly on a company-owned plane and pay the associated income taxes than to fly on a commercial airliner in coach class (p. 62). In addition, the income tax cost to the executive has often been substantially less than even the direct cost to the company for use of the plane (p. 62). Johnston describes such executive "perks" as an example of a stealth tax cut for the wealthy and powerful, and another way in which corporations and the tax code can, in effect, subsidize executives' personal lifestyles.[12]

After his indictment of big business, Johnston addresses a variety of specific tax issues. First, he discusses congressional efforts to repeal the estate tax. Johnston makes a convincing case that no family farms actually have been lost to the estate tax — the false premise that is the primary argument among politicians in favor of repeal — and that instead the beneficiaries of repeal (and the force behind the push for elimination of the tax) are wealthy individuals (pp. 71-79). In this context, he points out the power of rhetoric and slogans: "The term *death tax* is a superb example of marketing triumphing over reasoned debate."[13] He also points out that "repeal of the estate tax means a heavier reliance on taxes paid during life such as income taxes" (p. 85).

Johnston accuses politicians who voted for estate tax repeal of not only seeking to shift more of the tax burden onto wage-based income, but also of attempting to dramatically soften the burden on the wealthiest Americans by including provisions in the 2000 tax legislation — repeal of the gift tax combined with an unlimited basis step-up for assets transferred at death — that would have allowed individuals to transfer wealth from one generation to another while avoiding taxable gain (p. 86). This loophole was closed before Congress passed the final bill but, according to Johnston, such efforts "illustrate the drive by the political donor class to free itself from the burden of taxes" (pp. 90-91).

12. Pp. 67-70. Johnston points out that the company can deduct the cost of the use of the airplane. Pp. 62, 67. The American Jobs Creation Act of 2004, signed by the President on October 22, 2004, includes a provision that limits an employer's tax deduction for an executive's personal use of a company aircraft to the amount included in the executive's income as compensation. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 907(a), 118 Stat. 1418, 1654-55.

13. P. 81. Professor Lee Fennell points out that the broad unpopularity of the estate tax is puzzling given that only a tiny fraction of estates actually are subject to it, and, presumably, the revenue it collects forestalls increases in other taxes. *See* Lee Anne Fennell, *Death, Taxes, and Cognition*, 81 N.C. L. REV. 567, 593-94 (2003).

Next, Johnston discusses the alternative minimum tax ("AMT"), a separate set of rules in the tax code originally designed to ensure that wealthy taxpayers paid some minimum annual tax regardless of their deductions and credits. Johnston focuses on how the AMT operates nearly invisibly under current law to reduce the value of the "Bush tax cuts" for many taxpayers, mostly middle-income (pp. 94-95). Johnston seems to object to the opacity of the AMT, which he calls the "stealth tax" (pp. 92, 95), its impending effect on the middle class (pp. 104, 111), its effect on those with large families (p. 105), and what he calls "another levy"[14] on taxpayers.

Following the discussion of the AMT, Johnston focuses on the flip side of deferral, namely, payment in advance, in a chapter entitled "How Social Security Taxes Subsidize the Rich." He points out that, in recent years, workers have paid more in Social Security taxes than was paid out in benefits in those years, which, in effect, amounts to an advance payment of tax (pp. 118, 122-23). The extra funds "were used to pay the ordinary bills of the government, making up for the taxes that were no longer being paid by the rich because of the 1981 income tax cuts" (p. 123). Another "raid" on Social Security funds occurred in 2001, when Congress passed a series of tax cuts, the benefits of which flowed largely to upper-income taxpayers (pp. 126-27). Johnston explains that Social Security is an income redistribution program. He argues that the very poor receive benefits larger than their contributions and the "rich get nearly a free ride" because of the wage cap on contributions. Returning to one of his themes, Johnston states, "[i]t is the middle class and the upper middle class who pay the price for this inequity" (p. 125).

Chapter Nine is the first in a series of chapters that discuss the workings of the IRS. It focuses on audits of low-income taxpayers who claim the earned income credit ("EIC"), a refundable tax credit that can reduce or eliminate tax liability for the eligible working poor. Johnston points out that, "[i]n 1999, for the first time, the poor were more likely than the rich to have their returns audited" (p. 132). This is a difficult issue. The EIC requirements are complex and EIC claims do have a high error rate,[15] but there is little tax money at stake in an audit of a low-income individual.[16] Johnston recommends that Congress simplify the EIC and adopt a uniform definition of "child"

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14. P. 95. Johnston's analysis of the AMT is critiqued below. *See infra* notes 36-41 and accompanying text.

15. P. 138; *see also* Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 U. KAN. L. REV. 1145, 1146 (2003) ("Of the estimated $31.3 billion in EITC claims made by taxpayers filing in 1999, approximately $8.5 to $9.9 billion should not have been paid.").

16. For example, Professor Book notes that the maximum EIC for a taxpayer with two qualifying children in 2002 was $4,140. Book, *supra* note 15, at 1194.

for federal income tax purposes.[17] He claims that simplifying the EIC could reduce the amount of refund anticipation loans and check-cashing fees the working poor pay to private businesses to accelerate their EIC payments (pp. 141-44).

In the second half of the book, Johnston turns his attention more directly to issues of tax enforcement and the workings of the IRS, offering explanations for what he believes to be the Agency's failed enforcement practices and policies. Johnston attributes the IRS's failed enforcement practices primarily to structural changes brought about by IRS reform legislation enacted in 1998, which he characterizes as a "boon for tax cheats of all kinds" (p. 150). He recounts the circumstances surrounding the Senate Finance Committee hearings leading up to the 1998 legislation, at which taxpayers and some of the IRS's own employees testified to unlawful treatment by the Agency. Johnston points out that most of this testimony was later discredited (pp. 146, 155-56) and that the IRS could not adequately respond to its accusers because, by law, it must keep taxpayer information confidential (p. 148). Nevertheless, the hearings had their intended effect and Congress enacted widespread changes to the tax enforcement and collection process that, according to Johnston, "handcuffed the tax police" (p. 150).

One change that Johnston holds in particular disdain, and that he believes created the greatest hindrance to the IRS's ability to enforce the tax laws effectively, was the enactment of the "ten deadly sins" — a list of infractions by IRS employees for which the default sanction is termination of employment (p. 150). The threat of discharge, according to IRS personnel interviewed by Johnston, led front-line IRS employees to close audits quickly and to take a reluctant stance against well-connected, but noncompliant, taxpayers. This fear of reprisal, Johnston asserts, led to the documented decline in liens, levies, and seizures that followed IRS reform.[18]

In Chapter Eleven, Johnston discusses another important structural change brought about by the 1998 legislation — a

17. Pp. 140, 144. There has been a movement for such a change for a while. For example, the National Taxpayer Advocate included such a proposal in her 2001 report to Congress. NAT'L TAXPAYER ADVOCATE, ANNUAL REPORT TO CONGRESS 76, 80 (2001), *at* http://www.irs.gov/pub/irs-utl/2001_tas.pdf. Recently enacted legislation includes such a change. *See* Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, §§ 201, 205, 118 Stat. 1166, 1169, 1176.

18. Pp. 151-52. Others have stated this as well. *See, e.g.*, BARLETT & STEELE, *supra* note 1, at 131; Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 FLA. L. REV. 1, 107 (2004); Amy Hamilton, *Ten Deadly Sins: Effective Tool or Invitation to Employee Harassment?*, 85 TAX NOTES 1360 (1999); Ann Murphy & David Higer, *The 10 Deadly Sins: A Law With Unintended Consequences*, 96 TAX NOTES 871 (2002); Lee A. Sheppard, *The Sixth Deadly Sin*, 92 TAX NOTES 1018 (2001).

congressionally mandated reorganization of the IRS's organizational structure. The primary architect of the reorganization plan, and the IRS Commissioner who oversaw the plan's initial implementation, was Charles Rossotti. Johnston criticizes Rossotti's efforts in bringing cultural change to the IRS as being too heavily focused on so-called "customer" service at the expense of enforcement (p. 163). Johnston attributes much of the dramatic, across-the-board decline in audit rates during Rossotti's tenure (pp. 164-66) to decisions by Rossotti and IRS officials to direct enforcement resources toward low-income taxpayers, whose returns tend to be easier to audit but yield lower collections, rather than higher-income and business taxpayers, whose returns tend to be more complicated but more likely to generate higher tax collections.[19]

In a series of chapters criticizing the IRS's enforcement activities, Johnston offers examples of the IRS's inaction in the face of known acts of noncompliance. He recounts the tale of Jerry Curnutt, an IRS expert responsible for identifying erroneous partnership tax returns. After discovering entries on returns that might indicate fraudulent activity, Curnutt proposed a low-cost solution that, according to Johnston, would have generated millions of dollars in taxes due. Curnutt's proposal apparently drew little interest from his supervisors, which Johnston attributes to several factors, including political influence from wealthy campaign contributors (p. 172), lack of IRS funding (p. 182), and general mismanagement of the Agency (pp. 180-83).

Johnston also exposes the use of tax-exempt insurance companies to shelter hundreds of millions in investment profits from U.S. taxes (pp. 186-93) and identifies, by name, individuals who have invested in schemes designed to zero-out their tax liability, as well as others who simply have refused to file income tax returns (pp. 194-96, 201-02). In the face of these revelations, Johnston reports, the IRS showed a reluctance to, and in some cases seemingly refused to, pursue these individuals. According to Johnston, such noncompliance is a "rip in the social fabric that holds the nation together" (p. 203) and continues to grow because of IRS inaction.

As noted above,[20] Johnston often is at his best when discussing complex tax transactions. Chapter Sixteen, which analyzes the background, tax implications, and policy debate surrounding the cross-border dividend-stripping transaction at issue in the *Compaq* case,[21]

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19. Pp. 166-67. Later in the book, Johnston praises Rossotti for recognizing the negative effect his policies had on overall levels of tax compliance. P. 293.

20. *See supra* text accompanying note 5.

21. Compaq Computer Corp. v. Comm'r, 113 T.C. 214 (1999), *rev'd*, 277 F.3d 778 (5th Cir. 2001).

illustrates Johnston's gift for taking an otherwise dry topic and infusing it with interest and importance.[22] Johnston's discussion of efforts by U.S. businesses to reincorporate in tax haven countries in order to reduce their corporate tax liability is equally engaging. He entertainingly recounts the political debate surrounding the efforts by Stanley Works's management to convince shareholders to approve a reincorporation plan (pp. 237-50). Not part of the debate, Johnston points out, was the huge tax-free profits Stanley's high-level management would have realized had the reincorporation plan passed (p. 247).

While Johnston is highly critical of the IRS throughout the second half of the book,[23] he makes it clear that its failure cannot be attributed solely to the Agency's bureaucracy and inefficiency. He returns to the notion of an influential "political donor class," that, according to Johnston, not only influences the development of tax policy, but also affects the Agency's enforcement practices.[24] Although Johnston offers little direct evidence to support his belief, characterizing these themes as mere conspiracy theory would do a disservice to Johnston's skills as an investigative reporter. Facts uncovered by Johnston strongly suggest that IRS supervisors refused to support the conclusions of IRS agents who were auditing big oil companies like Unocal and Chevron, thereby raising serious questions about the IRS's priorities relating to enforcing the law and collecting revenue.[25]

Of course, the "political donor class" must necessarily draw its influence from politicians, so members of Congress, both Republican

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22. Pp. 220-27. Foreign tax credit manipulation of the type at issue in *Compaq* represents one of the few instances Johnston reports in which Congress acted to shut down, at least partially, a tax shelter–type transaction. *See* I.R.C. § 901(k) (imposing a holding period requirement for purposes of crediting foreign taxes associated with foreign-source dividends). More recently, Congress passed a host of provisions designed to further curtail the use of abusive tax-avoidance transactions, including expanded tax shelter disclosure requirements and increased penalties applicable to tax shelter promoters. American Jobs Creation Act of 2004, Pub. L. No. 108-357, §§ 815(a), 818(a), 118 Stat. 1418, 1581, 1584.

23. Throughout *Perfectly Legal*, Johnston describes the IRS as an agency subject to political manipulation and an unworthy adversary of those in the legal and accounting community. Johnston's stories in this regard appear not to be intended to generate sympathy for the IRS, but rather to stand as a strong critique of an IRS management unwilling to confront political pressure and of a Congress that intentionally underfunds the Agency.

24. P. 216 (reporting that twenty percent of IRS managers routinely observed preferential treatment given to taxpayers with "political clout").

25. Pp. 252-53. Similar accusations arose in 2004 relating to the IRS's audit of Micrel, Inc. *See* Warren Rojas, *Agent Says IRS Used Disclosure, Circular Referrals to Block Audit*, 104 TAX NOTES 687 (2004) (IRS agent accused of wrongdoing after making public allegations of collusion between corporation under examination and senior IRS executives).

and Democrat, do not fare well in Johnston's book.[26] Johnston accuses politicians not only of creating a hostile atmosphere toward tax enforcement, but also of underfunding the IRS in an effort to tie its hands (p. 295). He also attributes blame for the current state of tax enforcement to judges who ignore financial reality in favor of textualist constructions (pp. 224-26), lawyers who facilitate tax dodges by providing a sense of legitimacy to otherwise questionable transactions (p. 273), and accountants and advisors who market tax-saving schemes (pp. 269-70).

The prospects for improvement, in Johnston's mind, are dim. In the chapter entitled "Is Reform Possible?" Johnston relates efforts by politicians to block then-departing Commissioner Rossotti from issuing before Congress a stinging criticism of the IRS's enforcement activities and a call for increased Agency resources (pp. 292-96). As Johnston sees it, the spread of tax cheating is a predictable outcome of the government's failure to direct audit resources towards business owners and investors who have the greatest opportunity to cheat. Addressing some of the compliance problems through substantive reform of the income tax also presents serious challenges, according to Johnston, because of the capacity of lawyers and accountants to help clients manipulate the system and the recent penchant of Congress to make the tax code more complex.[27] Johnston raises the possibility of a switch from an income tax to a consumption tax, but seems to reject the idea, criticizing consumption taxes as regressive and skewed in favor of the rich, and a transition to such a tax as potentially economically disruptive (pp. 300-04). Fundamental reform, according to Johnston, "will remain elusive so long as Congress avoids the serious, and mundane, issues of how tax administration works, puts [] willfully uninformed [Congressmen] in charge of IRS oversight and shrivels the budget for tax law enforcement while handcuffing the tax police" (p. 304).

III. Does *Perfectly Legal* Live Up to Its Subtitle?

Perfectly Legal is a smooth and engaging read. Johnston is an excellent storyteller; he makes ordinary people and technical issues seem to come alive on the page. The stories work well as newspaper columns, where a single issue can be the focus. Unfortunately, the compilation of stories does not work as well as a book. Johnston

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26. Johnston does attempt to present a balanced picture, noting instances in which Congress acted to curtail tax schemes. *See* p. 227.

27. P. 298 ("Any real reform of our tax system must address the virtually unlimited capacity of financial engineers to fabricate profits and losses, to hide them in layers of complex transactions and to withhold documents that would enable auditors to understand these transactions.").

simply does not explain how the various topics fit together, nor does he make links between them.[28] If the book were divided into parts, each focused on a different aspect of Johnston's concern about the suffering of the "little guy" at the hands of politicians and their donors, it would be a better book. To do that, though, Johnston would have to give up the premise that the book is a comprehensive report on the tax system and admit that, in his view, the tax system is just one component of the problem.

Even then, the book would need more work to make its case that politicians and their donors are rigging the "system" (however defined) to harm the little guy. Certain chapters show quite persuasively that the effect of Congress's actions has been to cut taxes on the rich (notably, the estate tax repeal) or hamper tax collection (IRS reform). The facts reported in these chapters make a good case that these actions were no accident. In other chapters, however, the connection between political action and a burden on the poor or a tax break for the rich is left unstated. Is Johnston implying that such a connection exists?

There is a similar issue with respect to the corporate greed that Johnston laments. Johnston seems to ignore market forces, acting as if employees whose compensation or benefits are cut have no opportunity to seek jobs elsewhere, likely exaggerating the effects of the phenomena he discusses. But, assuming that he is correct, to what extent does Johnston blame politicians? The links Johnston makes between corporate activity and acts of Congress seem tenuous at best — Johnston does not explain the connection between them.

In addition, Johnston's economic analysis, though clearly not intended to be overly technical, is inconsistent at times. One of Johnston's themes is that there is "no free lunch,"[29] so that when one group lowers its taxes, another group has to bear the cost of that forgone revenue.[30] The basic principle that Johnston is expressing is as true of corporate taxpayers as it is of individual taxpayers (p. 12).

28. By contrast, *The Great American Tax Dodge*, which is similar in many ways to *Perfectly Legal*, *see supra* note 3 and accompanying text, expresses a clear theme to which each of its chapters relate. This makes *The Great American Tax Dodge* clearer and more convincing.

29. Johnston uses this phrase both to refer to taxes that are not paid by the rich, p. 11, and in the context of the cost of "the true price of deferral," p. 52.

30. Johnston also does not mention that some economists believe that lower taxes may spur growth in the economy, leading to the same amount of tax collections in the aggregate, while lowering the burden imposed on each taxpayer. *See, e.g.*, JOHN O. FOX, IF AMERICANS REALLY UNDERSTOOD THE INCOME TAX: UNCOVERING OUR MOST EXPENSIVE IGNORANCE 165-66 (2001).

Thus, if a corporate taxpayer lowers its tax bill, the rest of us will have to pay more.[31]

What about when a corporate taxpayer pays a *larger* tax bill? When discussing executive compensation, Johnston complains that when a company does not get a tax deduction for compensation paid, "shareholders had to pay an extra 35 cents [per nondeductible dollar of salary] to cover additional corporate income taxes" (p. 56). Assuming that a corporation is actually paying taxes at a thirty-five percent rate — an assumption that contradicts the statistics Johnston cites elsewhere[32] — then, all other things being equal, a forgone deduction costs a corporation thirty-five cents on the dollar. Johnston points out that either the shareholders may bear that cost (pp. 48, 56) or the cost may be passed along, such as through elimination of jobs or reduction of employee benefits (pp. 51-53).

Thus, Johnston finds possible burdens on people such as "rank and file workers" from both tax increases *and* tax cuts. The problem is that Johnston is looking only at one side of each equation. In the context of a tax cut for large corporations, Johnston's main point is that, if one group pays less in tax, others must pay more, in order for *tax revenue* to stay the same (assuming no growth in the economy — an issue Johnston does not address).[33] In the context of higher taxes for large corporations, the crux of Johnston's argument seems to be that if a company spends more on taxes, it must spend less elsewhere, such as on the compensation of rank-and-file employees, in order for *after-tax profits* to stay the same[34] (assuming market prices have not changed). What Johnston does not mention are corollaries to each of his arguments: Under Johnston's analysis, (1) if a corporation pays less in taxes and were to keep after-tax profits the same,[35] it would accordingly spend more elsewhere, such as on its employees, and (2) if large corporations pay more in taxes and tax revenues stay the same, then others should experience a tax cut.

31. For example, in Chapter Five, Johnston states, "Someone must bear the real costs of the use of company jets. They are borne by the shareholders, who may in turn deduct them on the corporate income tax return, forcing all taxpayers to pick up 35 percent of the true costs." P. 62.

32. Johnston notes that "[c]orporations . . . lowered the portion of their profits that go to federal income taxes from 26 cents of each dollar in 1993 to 22 cents in 1998, even though the official corporate income tax rate remained unchanged at 35 percent." P. 12. He also laments the rise of corporate tax shelters. *See* p. 41.

33. *See supra* note 30.

34. Johnston does not say this explicitly but it seems implicit in his statement that "[t]he true price of deferral may be hidden, but it still must be paid somehow and by someone," p. 52, and in other statements about the costs of deferral, including shrinking payrolls. *See* pp. 48, 51-53.

35. Of course, a corporation facing reduced tax liability may simply enjoy an increase in after-tax profits.

Johnston's discussion of the AMT similarly presents only part of the picture. As indicated above, an important focus of Johnston's discussion is how the AMT reduces the value of the "Bush tax cuts" for many taxpayers (pp. 94-95). For example, he states, "[b]etween 2003 and 2012 the Bush tax cuts will force an increase of $560 billion in taxes to be paid under the alternative minimum tax" (p. 95). It is probably the case that the loss of much-touted tax cuts was a surprise for many taxpayers. And it is certainly true that nonobvious and complex provisions impose costs on taxpayers. Johnston's discussion could imply that a tax cut actually increased federal income tax liability for some taxpayers, however.

As Johnston points out, the taxpayer pays the higher of the amount computed under the regular income tax or the AMT (p. 95). Thus, a taxpayer paying AMT is, by definition, paying more in taxes than he would if the AMT did not apply. And a taxpayer-favorable change under the regular tax without a corresponding change in the AMT will make more people liable for AMT, all other things being equal. But those two points combined do not add up to increased overall federal income tax liability resulting from the availability of a benefit under the regular tax.

For example, Johnston discusses the Klaassens, a family with ten children in 1994 who owed $1,085 more in tax than they had paid because they had not realized the AMT applied and had calculated their tax liability applying only the regular income tax (p. 105). According to Johnston, the calculations of Mr. Klaassen, a lawyer, revealed that "the [Klaassens'] eighth child set off the alternative tax at a cost of $223. A ninth child raised the bill to $717. And ten children, the number the Klaassens had in 1994, increased the tax bill by $1,085, the exact amount the IRS said was due in extra taxes for 1994" (p. 105).

Johnston does not report the amount of the Klaassens' income or deductions, but the Tax Court opinion in *Klaassen v. Commissioner* does,[36] so it is possible to calculate their regular tax liability and AMT under the scenarios Johnston raises. Although it is true that the Klaassens' eighth child caused the AMT to apply to them in 1994 in

36. Klaassen v. Comm'r, 76 T.C.M. (CCH) 20 (1998), *aff'd*, 182 F.3d 932 (10th Cir. 1999) (unpublished op.). According to the Tax Court opinion, for 1994, the Klaassens reported adjusted gross income ("AGI") of $83,056.42, itemized deductions of $19,563.95, which included $4,767.13 of medical and dental expenses and $3,263.56 of state and local taxes; exemptions of $29,400 (two personal exemptions and ten dependency exemptions, at $2,450 each); taxable income of $34,092.47; and regular tax of $5,111. *Id.* In 1994, married taxpayers were taxed at a rate of fifteen percent on taxable income up to $38,000 and at a twenty-eight percent rate after that. *See* Rev. Proc. 93-49, 1993-2 C.B. 581, 582, § 3.01 tbl.1. Fifteen percent of $34,092.47 is $5,113. The 1994 tax table, however, provides $5,111 as the tax on $34,050 to $34,100. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, INSTRUCTIONS FOR FORM 1040, at 45 (1994), *at* http://www.irs.gov/pub/irs-94/i1040.pdf.

the amount of $223,[37] that does not mean the Klaassens would have paid less in federal income tax if they had had seven children instead of eight or more.

According to the IRS's computations, which the Klaassens did not dispute, the Klaassens' tentative minimum tax for 1994 was $6,196, giving rise to AMT of $1,085.[38] If the Klaassens had had only seven children in 1994, their tentative minimum tax would have remained the same, $6,196, because dependency exemptions are disallowed under the AMT.[39] With seven children, however, the Klaassens would have had a regular tax liability of $6,659[40] — an amount that would have exceeded their tentative minimum tax.[41] Thus, if the Klaassens had had seven children in 1994, they would have owed no AMT but would have owed $463 *more* in federal income tax for 1994 than their actual liability of $6,196. Therefore, it is not the case that the Klaassen's eighth child increased their federal income tax liability. In fact, the opposite is true. Their eighth child reduced their tax liability by $463, and their federal income tax liability remained flat with their ninth and tenth children.

Of course there are problems with the AMT. Among other issues, if the AMT continues on its current trajectory, it will become a mass tax, which was not intended when it was enacted.[42] As Johnston points

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37. If the Klaassens had had eight children in 1994, their tentative minimum tax would have remained at $6,196, while their regular tax liability would have been $5,973 according to the tax tables. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, INSTRUCTIONS FOR FORM 1040, at 45 (1994), *at* http://www.irs.gov/pub/irs-94/i1040.pdf. It would have been $5,977 according to the tax rate charts. The difference between $6,196 and $5,973 is $223, the amount Johnston refers to as the AMT cost of the Klaassens' eighth child. P. 105. If the Klaassens had had nine children, their tentative minimum tax for 1994 would once again have remained at $6,196, while their regular tax liability would have decreased to $5,479 according to the tax tables. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, INSTRUCTIONS FOR FORM 1040, at 45 (1994), *at* http://www.irs.gov/pub/irs-94/i1040.pdf. It would be $5,481 according to the tax rate charts, or fifteen percent of $36,542. *See id.* Thus, with nine children, the Klaassens' AMT liability would be $717, just as Johnston reported. P. 105.

38. P. 105. In 1994, the AMT applied a flat exemption of $45,000 but disallowed the personal and dependency exemptions and the standard deduction. *See* I.R.C. §§ 55(d), 56(b)(1)(E) (1994); *see also Klaassen*, 76 T.C.M. (CCH) at 2. The 1994 AMT applied a rate of twenty-six percent at the Klaassens' income level. I.R.C. § 55(b)(1)(A)(i)(I) (1994); *see also Klaassen*, 76 T.C.M. (CCH) at 2.

39. *See supra* note 38.

40. With only seven children, rather than ten, the Klaassens would have had three fewer dependency exemptions for purposes of the regular federal income tax, increasing their taxable income to $41,442 ($34,092 + $2,450 * 3 = $41,442). Using the tax tables would yield a tax liability of $6,659. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, INSTRUCTIONS FOR FORM 1040, at 46 (1994), *at* http://www.irs.gov/pub/irs-94/i1040.pdf.

41. Thus, the Klaassens' AMT liability for 1994 would have been zero if they had had seven children, but that is because their regular tax liability would have been higher than their tentative minimum tax.

42. As one article comments:

out, however, that will likely not be the case until approximately 2010 (pp. 99-100). By then, if the AMT still exists, the tax law will likely have changed so that the effect of the AMT on individuals may be very different than it is now.

Despite these shortcomings in Johnston's discussion of the AMT, Johnston has provided a service in pointing out how AMT liability can be a trap for the unwary. Certainly a taxpayer who assumes that additional children will always lower tax liability is incorrect because of the AMT. Johnston's voice is a powerful one in promoting change and his focus on important tax policy issues that can be daunting in their technicality, such as the AMT and corporate tax shelters, is commendable.

IV. SUBSTANTIVE OR PROCEDURAL REFORM? THE COSTS OF PROCEDURAL COMPLEXITY

In the final chapter of *Perfectly Legal*, entitled "Conclusions," Johnston sums up his various arguments and makes several proposals. Initially, he calls for a complete overhaul of the tax system (p. 305), but he quickly backs away from this large-scale plan in favor of a series of more modest proposals that, he believes, would reverse the trend of shifting the tax burden from high-income to middle-income taxpayers.[43] These proposals include limiting a taxpayer's ability to defer reporting income to "very limited amounts in retirement savings plans and pension funds" (p. 313), requiring corporations to calculate tax liability based on financial accounting concepts (p. 313), eliminating special tax treatment limited to only certain industries,[44]

> The AMT grew out of a minimum tax that first took effect in 1970, due to legislation enacted in response to public outrage in the wake of testimony by Treasury Secretary Joseph W. Barr (1969) that 155 high-income households had paid no income tax in 1966. Although it has historically applied to only a very small share of taxpayers, the tax is projected to grow rapidly over the next decade, transforming it from a class tax to a mass tax.

Leonard E. Burman et al., *The AMT: Projections and Problems*, 100 TAX NOTES 105, 105 (2003). In 2001 and again in 2003, Congress increased the exemption amounts under the AMT, *see* I.R.C. § 55(d), thereby relieving some taxpayers of AMT liability. The increased exemption amounts were extended to tax years 2005 and 2006 by the Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, § 103, 118 Stat. 1166, 1168.

43. Pp. 312-17. He also calls for a serious debate over a possible move to a consumption tax, but it seems clear that he does not favor such a move because it would shift the tax burden onto labor and away from capital. P. 310. Johnston points out that recent legislative changes — reducing tax rates on capital gain and dividend income, for instance — have shifted tax burdens away from capital and onto labor. *See* Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, §§ 301(a), 302; I.R.C. § 1(h)(1), (11). These changes have moved the current nominal income tax closer in application to a consumption tax. *See generally* DAVID F. BRADFORD, UNTANGLING THE INCOME TAX (1986) (comparing a pure income tax and an income-based consumption tax).

44. P. 314. The American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418, is a recent example of the type of tax legislation Johnston laments. Passed by Congress in

overhauling the U.S. tax treatment of multinational corporations (p. 314), enacting legislation that would allow "each American a one-time opportunity to start a business and pay no taxes on profits for the first two or three years" (p. 314), eliminating limited liability for partnerships composed of accountants and lawyers (p. 314), and reforming or eliminating the alternative minimum tax (p. 315).

Some of Johnston's proposals for substantive change, such as his proposal to exempt new businesses from taxes, would add further complexity to an already complex tax code.[45] Other proposals, such as reformation or repeal of the alternative minimum tax, might entail simplification depending on how they were done. Johnston is quite concerned with complexity in tax law; he states that "[t]he most overwhelming need is to simplify the tax code" (p. 312). But simplification is not the principal driver of Johnston's reform proposals. Instead, what apparently animates these proposals is the theme that reappears throughout the book: the reduction of income inequality. Johnston's proposals are attempts to achieve that goal by assisting the lower and middle classes and reducing tax breaks that benefit the "super rich."[46]

Johnston also proposes a series of procedural reforms directed at the tax enforcement and collection process. Among other things, he advances some general ideas about enforcement measures that the IRS could add to its repertoire.[47] Johnston also declares that Congress should "unshackle the tax police" by ordering the IRS to pursue more aggressively both acts of noncompliance and those tax practitioners who facilitate noncompliance by their clients (p. 316). The extent to which lawmakers and the IRS, on its own initiative, have begun this process is open to debate. For the past several years, the Bush

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October of 2004, the legislation provides tax benefits for manufacturing concerns, the aviation and shipping industries, restaurant owners, and Alaskan whaling captains, among others.

45. Johnston points out that many new businesses are not initially profitable, anyway. P. 314.

46. Barlett and Steele offer a proposal in *The Great American Tax Dodge* that is designed not only to address the issues of wealth and income inequality, but also to reduce the substantive complexity of the federal income tax. They recommend replacing the current income tax with a simplified, highly progressive income tax. *See* BARLETT & STEELE, *supra* note 1, at 261-63. Their proposal is both more comprehensive and more ambitious than Johnston's set of recommendations, and would also entail more radical change to the tax system if adopted.

47. Johnston states:

> Congress . . . should order them [the "tax police"] to aggressively pursue people who do not pay any taxes or pay on only a slice of their income. Comparing income to zip codes, buying lists of newly formed businesses and otherwise making sure no one can get away without filing a tax return would be both fair and lucrative.

P. 316.

Administration has proposed additional IRS funding earmarked for increased enforcement programs,[48] but regulators insist that the increases that have actually materialized have been too small to sustain an adequate level of enforcement.[49] The current IRS Commissioner, who immediately succeeded Commissioner Rossotti, said early in his tenure that he intended to reinvigorate the IRS's enforcement programs,[50] and new efforts have been taken by the IRS to increase its regulation of tax practitioners.[51] In spite of these developments, the IRS Oversight Board has reported a trend of decreasing commitment to tax compliance by the general public.[52]

In an effort "to protect taxpayers from zealous IRS agents," Johnston also proposes granting taxpayers whose returns were audited but showed no additional liability a $100 reward for their trouble (pp. 316-17). It is unclear how such a program would guard against misconduct or abuse of discretion by examining agents. The $100 reward could lead to inefficient and excessive auditing practices, encouraging IRS agents to assert insignificant issues in order to ensure some increase in the taxpayer's liability, no matter how small.

In order to encourage timely filing and payment, Johnston also advocates publicizing whether a taxpayer filed the required returns and paid the accompanying tax liabilities. Whether Johnston believes that making such information available to the public would pressure taxpayers into reporting honestly or encourage taxpayers to rat out their neighbors also is not clear. Such a proposal, however, is inconsistent with the tax code's legitimate concern for taxpayer confidentiality and might occasion taxpayer distrust that could

48. *See* George Guttman, *The IRS's Fiscal 2004 Budget: More or Less?*, 98 TAX NOTES 486, 486 (2003); Allen Kenney, *IRS Hopes for Funding Boost Dashed by House Bill*, 104 TAX NOTES 1475, 1475 (2004).

49. Mark Everson, *Everson Says IRS Budget Cut Would Jeopardize Enforcement Activities*, 2004 TAX NOTES TODAY 189-22; Kenney, *supra* note 48, at 1476. The IRS Oversight Board, created by the reform legislation in 1998, is a frequent critic of inadequate IRS funding. *See* IRS OVERSIGHT BD., 2004 ANNUAL REPORT 1 (2004) *at* http://www.treas.gov/irsob/documents/ 2004_annual_report.pdf ("The IRS Oversight Board has consistently argued that the IRS needs more resources to fight back and close the tax gap.").

50. *See* Heidi Glenn, *Everson Confirmed by Senate*, 99 TAX NOTES 621 (2003) (quoting Everson as saying that the IRS "must strengthen its enforcement of tax laws and work with tax practitioners to ensure all taxpayers pay their fair share").

51. *See* Heather Bennett, *ABA Tax Section Meeting: Everson Denounces Shelters, Warns Practitioners to Follow Law*, 103 TAX NOTES 795 (2004) (reporting that the recently appointed IRS Director of Practice issued a warning to practitioners about eroding standards of conduct).

52. IRS OVERSIGHT BD., 2004 ANNUAL REPORT 11 (2004) *at* http://www.treas.gov irsob/documents/2004_annual_report.pdf (reporting a continuing decrease in the percentage of Americans who feel that it is not at all acceptable to cheat on their income taxes).

undermine voluntary compliance.[53] By contrast, Johnston's suggestion that the IRS should aggressively pursue tax evaders and promoters of evasion is a good one. Visible enforcement helps promote confidence in tax administration, which undergirds voluntary compliance.[54]

Although Johnston wants to "unshackle" the IRS, he does not specifically propose eliminating any of the 1998 "reforms."[55] The set of procedures enacted in 1998 probably increases perceptions of procedural fairness by allowing taxpayers additional procedural rights and opportunities to tell their side of the story,[56] but, ironically, the increase in taxpayer "rights" and the procedural requirements applicable to the tax dispute resolution process, particularly collection activities, along with a restructuring of the Agency, resulted in enforcement grinding almost to a halt for a period of time.[57] In a way, that is not surprising, because the procedural rules Congress enacted in the IRS Reform Act bear two hallmarks of complexity — they are both "dense"[58] and "technical."[59] And hindering IRS enforcement

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53. *See* I.R.C. § 6103(a) (declaring that tax returns and related information shall be confidential); *see also* Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 U. KAN. L. REV. 1065, 1073 (2003) ("[A] perception on the part of the public that the IRS does not respect their privacy interests could generate resentment and a diminished commitment towards compliance.").

54. *See generally* Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453 (2003).

55. P. 316. Although Johnston does not say so here, this prescription may entail repealing the "ten deadly sins," which he criticized earlier in the book. *See* p. 150; *supra* text accompanying note 18.

56. *See* Kent W. Smith, *Reciprocity and Fairness: Positive Incentives for Tax Compliance*, *in* WHY PEOPLE PAY TAXES 223, 227 (Joel Slemrod ed., 1992); *see also* Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 996-1004 (2003).

57. *See* pp. 151-52 (reporting statistics); *see also* Lederman, *supra* note 56, at 983-88 (same).

58. In discussing legal complexity, Professor Schuck refers to rules that "occupy a large portion of the relevant policy space and seek to control a broad range of conduct, which causes them to collide and conflict with their animating policies with some frequency" as "dense" rules. Peter H. Schuck, *Legal Complexity: Some Causes, Consequences, and Cures*, 42 DUKE L.J. 1, 3 (1992). Although he does not specifically refer to procedural rules, the term should be just as applicable in the procedural context.

59. *Id.* at 4. Schuck has written that:

> *Technical* rules require special sophistication or expertise on the part of those who wish to understand and apply them. Technicality is a function of the fineness of the distinctions a rule makes, the specialized terminology it employs, and the refined substantive judgments it requires. The Internal Revenue Code is probably the leading example of technical rules.

Id. (footnote omitted). Again, Schuck does not expressly refer in this context to the complexity of procedural rules, but the analysis remains applicable. For example, the collection due process procedures enacted in 1998 entail fine distinctions, specialized terminology, and refined judgments by both the IRS and the United States Tax Court. *See* Leslie Book, *The Collection Due Process Rights: A Misstep or a Step in the Right Direction?* 41 HOUS. L. REV. 1145 (2004); Danshera Cords, *How Much Process is Due?: I.R.C. Sections*

action apparently was not far from the minds of some legislators, who stated such things as:

> I think a recent Newsweek Magazine article said it best: The IRS has too much muscle, too much money, and too little oversight. The agency is out of control and it is not going to fix itself. Only Congress can do that. In my view, we should overhaul — if not eventually abolish — the IRS. Then we should scrap the Tax Code and replace it with one that is fairer and flatter.[60]

The hand-tying procedural complexity here, unlike in other contexts, does not consist of administrative exhaustion requirements or other rules that limit the rights of complainants.[61] Instead, it is the Agency itself that suffers the constraints of procedural complexity.[62] Procedural complexity in tax administration should concern Johnston because it facilitates noncompliance by those seeking to postpone or avoid payment. For example, many tax protestors have taken advantage of the collection due process procedures.[63] Additional procedures also require additional IRS time, so that the IRS cannot process as many cases with the same number of employees.

6320 and 6330 Collection Due Process Hearings, 29 VT. L. REV. 51 (2004); *cf.* Richard E. Levy & Sidney A. Shapiro, *Administrative Procedure and the Decline of the Trial*, 51 U. KAN. L. REV. 473, 505 (2003) ("As history has shown, adding procedures may ossify the administrative process and sacrifice the ability of agencies to take effective action.").

60. 143 CONG. REC. E2306 (daily ed. Nov. 10, 1997) (remarks of Rep. Riley); *see also* Lederman, *supra* note 56, at 1010 n.188 (quoting other statements in the congressional record). More recently, Congressman J. Dennis Hastert called for the passage of a flat tax and the elimination of the IRS. *See* DENNY HASTERT, SPEAKER: LESSONS FROM FORTY YEARS IN COACHING AND POLITICS 272 (2004).

61. *Cf.* Margo Schlanger, *Inmate Litigation*, 116 HARV. L. REV. 1555, 1650-51 (2003). Professor Schlanger explains:

> [T]he [Prison Litigation Reform Act] imposes no constraints on the structure or rules of any grievance processing regime. The administrative review scheme can, for example, have as short a deadline for inmates and as many layers of review (to each of which the inmate must apply) as the incarcerating authority chooses. Essentially, then, the sky's the limit for the procedural complexity or difficulty of the exhaustion regime.

Id. at 1650 (footnote omitted).

62. One type of procedural complexity agencies can be faced with is in prescribing rules or regulations that properly implement legislative mandates. *See* Stephen T. Maher, *Getting Into the Act*, 22 FLA. ST. U. L. REV. 277, 285 (1994) ("Agencies that implement legislative mandates sometimes have difficulty complying with procedural complexities while adopting rules. The more complex the rulemaking procedure, the more likely it is that agencies will make mistakes.").

63. Professor Camp explains:

> As implemented, the [collection due process (CDP)] provisions have been a boon to tax protestors and a pain to everyone else. As of July 31, 2003, a review of the LEXIS database shows that since RRA 98's enactment, courts have decided 328 appeals from CDP hearings. Of those, at least 145 involved taxpayers who could reasonably be called tax protestors.

Camp, *supra* note 18, at 122 (footnote omitted).

David Bradford has distinguished among three, often interconnected, types of tax complexity:

> "compliance complexity" (referring to the problems faced by the taxpayer in keeping records, choosing forms, making necessary calculations, and so on); "transactional complexity" (referring to the problems faced by taxpayers in organizing their affairs so as to minimize their taxes within the framework of the rules); and "rule complexity" (referring to the problems of interpreting the written and unwritten rules).[64]

Each of these are clearly related to the application of substantive tax law to taxpayers (the regulated). They are not directly applicable to the IRS (the apparent regulator). Procedural complexity, however, imposes compliance complexity and rule complexity costs on the IRS — albeit different versions of these types of complexity from those that taxpayers face. In essence, the IRS functions as the regulated in its interactions with Congress, its regulator.

Thus, procedures enacted to help the "little guy" stand up to the IRS, such as those that restrict seizure of principal residences[65] and assets used in a business,[66] as well as the collection due process procedures,[67] while protecting some taxpayers, have imposed costs on the IRS.[68] These procedures impose genuine restrictions and delays on IRS action, both by requiring the IRS to surmount additional procedural hurdles, such as sending additional notices,[69] and because they provide taxpayers with procedural rights that require Agency time.[70] The cost of any particular provision in isolation may be less

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64. BRADFORD, *supra* note 43, at 266-67.

65. *See* I.R.C. § 6334(e)(1) (requiring approval of the U.S. district court before the IRS may levy on a taxpayer's principal residence).

66. *See id.* § 6334(e)(2) (requiring approval of the IRS district director before the IRS may levy on certain assets used by a taxpayer in his trade or business).

67. *See* Camp, *supra* note 18, at 121 ("[T]he collection due process provisions. . . undermine the Service's tax liability decisionmaking.").

68. Professor Boris Bittker has advanced what Peter Schuck terms the "audience principle," which "holds that the complexity of a rule should be tailored to the sophistication and cost-bearing capacities of those who will have to interpret and implement it." *See* Schuck, *supra* note 59, at 45 (citing Boris I. Bittker, *Tax Reform and Tax Simplification*, 29 U. MIAMI L. REV. 1, 5 (1974)). This analysis applies equally well to the IRS as it does to taxpayers. That is, the IRS apparently did not have the capacity to bear the costs of restructuring the Agency and implementing numerous complex procedures while maintaining the same level of enforcement of the tax laws.

69. *See, e.g.*, I.R.C. § 6330 (requiring pre-levy notice of right to collection due process hearing); *id* § 6751 (requiring detailed penalty notices); *id.* § 7609 (requiring the IRS to notify taxpayer of third-party summons); *cf. id.* § 6404(g) (suspending accrual of interest on tax deficiency and accrual of certain penalties if IRS does not notify taxpayer of asserted deficiency within a certain period of time).

70. *See, e.g.*, *id.* § 6015 (expanding the grounds upon which a spouse may be relived of joint and several liability); *id.* § 6320 (requiring post-lien filing opportunity for a hearing at

noticeable than its benefits, but the aggregate costs of procedural complexity are too large to be assumed away, because, as Johnston points out, the costs of IRS inaction are also borne by taxpayers.

V. CONCLUSION

Johnston is certainly not the first author to reveal instances of corporate welfare, to allege political corruption within the IRS, or to point out political manipulation of the Internal Revenue Code. Academics have debated these issues on a much broader scale than Johnston does in his book. *Perfectly Legal* is not an academic monograph, nor is it intended to be. Citations are scarce and some of those that exist cite to Johnston's own *New York Times* articles (*see* pp. 319-27). Nonetheless, Johnston generally demonstrates a command of substantive tax law, as well as an understanding of tax compliance and the economics of the topics he discusses.[71] The fact that he does not address economic theories in depth generally does not detract from his arguments and also may explain why the book remains interesting and lively. In certain instances, however, his efforts to draw conclusions with a broad brush lead to inconsistent statements and unanswered questions.

The book also suffers from a lack of organization, so that the focus sometimes switches abruptly from one chapter to the next, but this undermines the case Johnston is trying to make more than it affects the book's readability. Once the argument Johnston makes is considered carefully, the pattern that emerges from the series of narratives that comprise *Perfectly Legal* is not so much an investigative report of the tax system, but rather a populist lament in which the greed of the top executives of large corporations bears as much responsibility as lawmakers do.

Undoubtedly, not everyone will agree with Johnston that corporations and Congress have combined in a "covert campaign," but *Perfectly Legal* is an enjoyable and informative read nonetheless. Johnston is a good storyteller and *Perfectly Legal* is an interesting book that should be accessible and informative to the general public. Johnston also raises important issues about the tax system that ordinarily are not the focus of books of this type. His report on the workings of the IRS is both unusual in its perspective and very informative. Johnston's analysis of the federal law that tied the hands

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the IRS Appeals Division); *id.* § 6330 (requiring pre-levy opportunity for a hearing at the IRS Appeals Division); *id.* § 7491 (shifting the burden of proof to the IRS in court cases if the taxpayer establishes necessary elements); *id.* § 7609(a) (expanding taxpayers' right to quash third-party summons).

71. According to Johnston's web site, he was a student of economics at several colleges, including the University of Chicago. *See* http://www.perfectlylegalthebook.com/author.htm.

of the IRS also underscores the importance of simplification — not just of substantive tax law, but of procedural tax law as well.