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2008

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Recommended Citation
Kahn, Douglas A. "Condemnation Without Justification." Tax Notes 118 (2008): 531-2.

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Condemnation Without Justification

By Doug Kahn

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On August 6-8, 2007, Prof. Neil Buchanan posted in Michael Dorf's blog (http://michaeldorf.org/; for the blog entry regarding the death tax, see http://michaeldorf.org/2007/08/dishonest-tax-rhetoric-part-3-of-3.html) a three-part series on what he deemed to be examples of political use of terminology to describe tax issues in a manner that is likely to mislead the public. Prof. Buchanan described this practice as ''dishonest tax rhetoric.'' He awarded first, second, and third prizes for the most egregious examples of dishonest rhetoric. I, however, found no objection to the usages he considered to be the two worst examples. Let us consider his first and second prizes.

His first prize went to the use of the term ''death tax'' when referring to an estate tax. Prof. Buchanan points out that other taxes (such as income and property taxes) are not described by reference to the date on which they become payable. But the significance of the death of a decedent to the estate tax is quite different from the date of payment of an income or property tax. An income tax is imposed on the earning of income; but to enforce the tax, there has to be a date for its determination and collection. The payment date is no more than an administrative stage for collection. However, a death tax is not merely payable or determined on the date of death; it is the death itself that is the *trigger*. The decedent's death is not merely an administrative step toward collection. To the contrary, it is a crucial element of the creation of the tax liability. No death, no tax. An income tax liability accrues (in a general sense) before its collection date, but an estate tax liability does not accrue before the decedent's death.

Moreover, the term ''death tax'' has been used by estate lawyers for many years — long before the question of the retention of a federal estate tax became an issue. Indeed, the code itself uses the term ''death tax'' and has employed that term for more than 53 years. Section 2011 is titled ''Credit for State Death Taxes.'' Section 2014 is titled ''Credit for Foreign Death Taxes.'' Section 2015 is titled ''Credit for Death Taxes on Remainders.'' Those three sections were adopted in 1953 as part of the Internal Revenue Code of 1954.

Prof. Buchanan treats the term ''death tax'' as an inappropriate synonym for an estate tax. But that is not correct. The term ''death tax'' is broader than an estate tax. An estate tax is merely one type of death tax. The term ''death tax'' includes estate taxes, inheritance taxes, legacy taxes, and succession taxes. An inheritance tax is different from an estate tax.

The second prize (or silver medal) that Prof. Buchanan awarded was for the national sales tax that has been proposed as a substitute for the income tax. Prof. Buchanan maintains that the proponents of that tax have calculated the rate of tax in a manner that is designed to mislead the public into thinking that the rate is lower than it actually is. He has other objections to the substitution of a sales tax, but he awarded the prize for the manner in which the rate of tax was determined by the proponents.

The proponents of the tax claim that it could be set at a 23 percent rate to provide the same revenue that the income tax provides. Prof. Buchanan contends that the average member of the public is likely to be misled by that statement. He offers the following example.

X pays $100 to purchase an item and then pays $30 in tax. X has paid a total of $130 to purchase the item, of which $30 is the tax. The proponents of the tax describe the rate of tax as 23 percent because $30 is 23 percent of the $130 total outlay. In other words, the proponents compute the rate of tax on a tax-inclusive basis. Prof. Buchanan contends that that is misleading. If the tax rate were described on a tax-exclusive basis, the rate would be 30 percent — the $30 tax is 30 percent of the $100 paid for the item exclusive of the tax. Because sales taxes currently are, and always have been, described on a tax-exclusive basis, Prof. Buchanan argues that the public will construe the 23 percent rate as meaning that they would pay a tax of $23 on a $100 purchase of an item.

There is a reasonable basis for describing the tax on either a tax-inclusive or a tax-exclusive basis. Income tax rates are provided on a tax-inclusive basis. One reason for describing the income tax in that manner is that the tax is easier to calculate that way. Similarly, the sales tax is easier to calculate if the rate is described in a tax-exclusive manner, and that is a likely reason that that method is employed for the sales tax. Prof. Buchanan himself essentially concedes that the use of the 23 percent rate is reasonable, stating that it ''has at least some basis in reality.'' However, he believes that the 23 percent rate was chosen because it is likely to confuse the public. He states, ''It is the difference between lying and intent to deceive.''

But would stating that the rate of tax is 30 percent not also mislead the public? A major purpose of stating the rate of tax is to give the public a means of comparing the proposed sales tax with the income tax that it would replace. But, as noted above, the income tax rates are determined on a tax-inclusive basis. If one earns $130 and pays an income tax of $30 to the government, the tax rate is described as a 23 percent rate, not as a 30 percent rate. If the public is to compare the cost of a sales tax to the cost of an income tax that it would replace, it needs to have rates determined in a comparable manner. If a taxpayer earns $130, pays $30 in income taxes, and spends the remaining $100 to purchase an item, his tax rate is referred to as 23 percent. If the income tax were replaced by a sales tax, and if the taxpayer purchased the same item for $100 and paid $30 in sales tax, his tax rate should be considered the same as it was under the income tax regime. If you tell the taxpayer that if a sales tax is adopted, his tax rate will change from 23 percent to 30 percent, you would mislead him into thinking that his tax liability would be greater under the sales tax.

The fact is that either method of determining the tax rate has the potential to mislead when the listener does not understand the difference in methods of determination. The method chosen by the proponents of the tax actually seems better to me in that it provides a more accurate figure for comparison. If a taxpayer knows that he is paying income tax at an average rate of 25 percent, the 23 percent rate gives him a better figure for comparison than does the 30 percent rate that a tax-exclusive determination would provide. I could not criticize anyone for using either the 23 percent or 30 percent rate, because each has its merits and its disadvantages. I certainly cannot see how the use of either rate could qualify for an award for dishonesty.

The choice of the 23 percent rate likely was motivated, at least partly, by advocacy considerations. The use of language for advocacy purposes is a common occurrence and is by no means used exclusively by politicians. For example, lawyers — and even law professors — have been known to indulge in that practice. The preference for using a 30 percent rate could be seen as driven by political or advocacy considerations to make unfavorable the comparison of the sales tax to the income tax.

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