EconoFact Chats: The Evolution Of, and Challenges To, the Income Tax
Daniel N. Shaviro, NYU School of Law
Published on 12th November 2023

Michael Klein
I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
The 16th Amendment to the United States Constitution states, in its entirety, 'The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census [or] enumeration.' This amendment was ratified on February 13, 1913. Since then, of course, there has been a great deal of debate and controversy about the federal tax system, and many laws have been passed that dictate who can be taxed, by how much and what does and does not constitute income. In December, the Supreme Court will hear oral arguments in the case of Moore v. United States. This case challenges the constitutionality of part of the 2017 Tax Cuts and Jobs Act. A ruling for Moore could result in both huge windfalls for large multinational corporations, and it could also dismantle large parts of the existing tax code. To discuss this case and its possible implications, I am pleased to welcome to EconoFact Chats Professor Daniel Shaviro of New York University School of Law. Dan is the Wayne Perry Professor of Taxation at NYU. His research focuses on tax and fiscal policies, along with inequality, and the intersection between law, literature, and social science. His newest book, published last year, is *Bonfires of the American Dream in American Rhetoric, Literature and Film*. Dan, welcome to EconoFact Chats.

Daniel Shaviro
Thanks, Michael.

Michael Klein
Dan, to give some background, many of our listeners may be surprised to learn that the income tax was introduced 110 years ago with the ratification of the 16th Amendment. That was during the progressive era when other policies were introduced like anti-trust legislation, and also the Federal Reserve. Can you give a bit of background on the introduction of the income tax and how controversial that decision was at that time?

Daniel Shaviro
Well, it may be hard for people today to imagine this, but in fact it was very popular. As background, income tax initially was just going to be on very rich people, so it was considered what we call a kind of a 'class tax' instead of a 'mass tax.' Also, it was something that had, it was to some extent going to be replacing tariffs that everyone felt they paid. In fact, there had been an income tax towards the end of the 19th century, but an extremely unpopular decision by a right-wing Supreme Court had basically contrary to all the precedents held that it as unconstitutional. This was viewed as restoring the status quo before that decision and sort of enabling democracy, small D, and having some scope for ability to pay target rich people having

all that take effect. So it was actually super popular at the time and really had in fact bipartisan support.

Michael Klein
So that, as we know, is not necessarily the case today. And as I mentioned, there have been many revisions to the tax code. One of the most significant in the last half century was the Tax Reform Act of 1986. Dan, you were working for the Joint Congressional Committee on Taxation at that time, and you worked on that tax reform. Can you briefly tell us how that act changed the tax codes and the significance of those changes?

Daniel Shaviro
Well, the background to it was there had been a lot of bad press for the tax law based on stories about wealthy corporations, high-income corporations paying no tax, and wealthy people using tax shelters. So the two parties started this bipartisan process believing that the law would be popular, which actually turned that not to be true. But the basic aim was to fight tax shelters and complete tax avoidance by big companies and very rich people. And the other part of the main idea, which helped bring the two parties together was to broaden the base and lower the rates. That said, they did have to do a lot of kind of odd and funky things to achieve their revenue targets. And also an important thing that they did was to shift liability kind of from individuals to corporations. Because kind of no one really knows who really pays the corporate tax. So it meant that you could have a revenue-neutral bill in which everyone got a tax cut, seemingly.

Michael Klein
Seemingly. And then another change to the tax code was much more recent, the 2017 Tax Cuts and Jobs Act. What were some of the key parts of that act?

Daniel Shaviro
Well, that was very different from 86 in that it was a one-party bill. In fact, zero Democrats in both the House and Senate voted for it. And it was tightly constrained by various budget rules and the like that required it to get a majority, but avoided having to need like 60%. Anyway, the big thing they did was cut taxes for business and for rich people. A huge change, which actually I should say the Democrats were not wholly against, except it went further than they wanted to, was to cut the corporate tax rate from 35% to 21%. At the same time, they also enacted some weird special tax breaks for self-employed rich people, basically. And one of the interesting things about it was that it didn't cut taxes quite as much as you would have expected for big multinational corporations. The way I put it when I was writing about it at the time was in like the play 'Death of a Salesman,' Willy Loman talks about being liked versus being well-liked. It turned out the multinationals were merely liked by the Republican majority. The well-liked people were the domestic big partnerships and such whom they handed bigger tax breaks to. So as a result, there were some rules that made it tougher for multinational corporations than it had been before. And if they were happy with the bill as a whole, which I think they were, it was chiefly just due to the rate cut that all companies got.

Michael Klein
So, following with 'Death of a Salesman,' you said it was a regressive tax and 'a salesman is not an orange,' the parlance of that play. And it was regressive, in fact. The part of the Tax Cuts and

Jobs Act that's challenged, in the Moore case, is what's called the mandatory repatriation tax, known by its acronym MRT. Can you explain what this is, Dan, and why it's controversial?

Daniel Shaviro
Well, before the act, multinational corporations that had income stashed in foreign countries were, in theory, taxable on that income in the U.S., even though it was foreign source and earned through a foreign subsidiary. But it was only taxable when it came home, when it was repatriated, such as through a dividend. So in 2017, they got rid of the tax on repatriation, basically told companies you could bring the money home completely tax-free. On a going forward basis, they kind of adjusted for that by having more of the income be currently taxable than it used to be. But what they figured was that for the old stuff, it's like you knew this was taxable at the time, we were just waiting until you brought it home. Now we're eliminating the tax on when you bring it home. So we're just going to have a one-time tax now to kind of compensate the government, the revenue interest, for the fact that you're eliminating all these future deferred taxes. We're going to charge you today, but at a much lower rate. So the idea was we're trading in the stuff that was merely deferred that you thought was taxable in full. We're going to tax it at a lower rate right away. That was basically the essence of it.

Michael Klein
And so why is this being challenged? It seems that the focus of the challenge is whether unrealized sums can be counted as income. But are these sums actually unrealized?

Daniel Shaviro
Well, what does realization mean? It's a term of art, it's not self-defining. What most tax experts would say about it is that the income has been realized at the corporate level by corporate entities. But more of an open question is whether it's been realized at the individual level with individual shareholders, such as the taxpayer who's raising this challenge.

Michael Klein
I know you've been involved in some amicus briefs of this. What are the amicus briefs saying about the Moore versus US case?

Daniel Shaviro
There are a whole bunch of things that are being said. One thing is that it's clear because the Supreme Court claims to be Originalist and about original meaning, there's very strong historical research being incorporated in the briefs that shows that when the amendment to the Constitution was adopted, there was really no doubt that this sort of thing would be constitutional. So one thing they're arguing is that it's within the notion of income at the time. A second thing they're arguing is that of the Eisner v. Macomber case from 1920, which I think we'll get to in a moment, is an early Supreme Court precedent that arguably really gives the taxpayer its best shot of winning the case. But it's been argued that that case was wrong when decided, and also that it's been subsequently cut back. There's also a whole separate line of argument, which is the tax could be upheld either in the ground that it really is income within the 16th Amendment or sort of esoteric line of argument that it's, quote, an excise tax. So, there are several paths for it's being constitutional. The taxpayer has to win every single argument in order to win the case.

Michael Klein
So you referred to this earlier case, the Eisner case. Can you give a little background on that please?

Daniel Shaviro
Well, this case, individuals received stock dividends from a company. An example of a stock dividend would be for every 10 shares of stock you already have, you get one more. Or a stock split would be a 50-50. Every one share of stock you get one more. Basically, it was argued by the taxpayer that this wasn't a realization even though you in fact got another piece of paper called a stock dividend. And the ground which they argued that was that it's simply dividing the same company into more pieces. So everyone agreed that a cash dividend, when you're paid cash, is going to be a realization. There was a stock dividend and the argument, basically because there are five votes on one side and four on the other, the court held that it wasn't realized. By the way, the best opinion in the case was by Justice Oliver Wendell Holmes, which is like about two paragraphs, which he said. To paraphrase, "if you asked a million people who in 1913, whether this was constitutional, they all would have said yes."

Michael Klein
So, these cases have consequences, of course. And one of the consequences of the Moore case, if it's found in favor of the plaintiff, is that there would be tax losses to the government. Are there estimates of how big those losses would be?

Daniel Shaviro
Well, the problem is it completely depends on the grounds on which the court strikes it down. To give you an example, these particular taxpayers have, I think, about $15,000 of liability at stake. They're challenging the mandatory repatriation tax, but 99% of the mandatory repatriation tax is paid by companies, not by individuals. And you could definitely write a decision favoring the taxpayer in which only the individuals win. In that case, it would only be 1% of all the revenue from the mandatory repatriation tax that would be lost. You could also write the decision so narrowly that pretty much nothing else whatsoever would be affected. So at the low end, it's just super trivial, but at the high end, and again, it depends on how a hypothetical decision favoring a tax we would written, you could kind of do a whole lot more damage, and it would probably be in billions or tens of billions or even hundreds of billions.

Michael Klein
Like President Johnson said, $1 billion, $2 billion, now you're starting to talk real money.

Daniel Shaviro
Right.

Michael Klein
Dan, this case seems somewhat at odds with the efforts by countries to institute a global minimum tax that would hamper the efforts by multinational corporations to move profits to low-tax countries in order to reduce their tax liabilities. What do you think of the efforts to have a global minimum corporate tax, in the way this case could impact that?

Daniel Shaviro
Well, starting with the last part, how could it impact that? It is possible. Again, the Supreme Court could write a decision in which the taxpayer wins, which either has absolutely no effect on that, or that makes it impossible for the U.S. to comply with the global movement. Of course, it's possible the U.S. won't comply with it in any event. In terms of the efforts themselves, this is one of the things that tax professors who care about international tax law are talking about all the time. The movement, there are a lot of criticisms of it, but I think it's very hard to answer a question about a good tax policy or one that's being followed without asking compared to what. My personal opinion is that this set of rules would make the international tax system much better than it is today. But if you gave me the freedom to design my own rules, or any of the people I know in the field, for them to design rules, you could make it much better than this. So it's like a half-empty versus half-full type of the thing.

Michael Klein
Or a camel is a horse designed by a committee?

Daniel Shaviro
Yes, except in this case, there are 140 nations designing it. So maybe there are 140 humps on the camel.

Michael Klein
It's a big camel.

Daniel Shaviro
Of that said, some of the some of the countries have less say than others. Like if you asked who had more influence on this, France and Germany or the Turks and Caicos Islands, I think we could probably guess which one had more influence.

Michael Klein
Well, we'll leave up that to our listeners to figure out the answer to that one. Another thing about the Moore case, the former House Speaker Paul Ryan said that the case raises the risk that if the decision goes to the plaintiffs, to Moore, then in his words, you're going to basically get rid of, 'I don't know, a third of the tax code.' What did Paul Ryan mean by that?

Daniel Shaviro
He was referring to the high end of the Supreme Court striking things down, which they could say, for example, that if you don't get cash, that there's no taxable, it's possible that they could write the opinion in such a ludicrous way that, and I imagine there'd be two votes for doing this for sure, that for example, if you go to your bank and you get a certificate of deposit and you can't cash it for three years, that you would then not have interest income on your bank account. That would also, that sort of way of writing the opinion would destroy financial markets. It would, for example, make it impossible to tax a partnership on undistributed profits. I mean, again, I don't think this is going to happen, but just to show the absurdity of it, you could have a case where a law partnership, as long as they don't distribute their earnings to the partners, they don't have to pay any tax until they do that, and law partners could like find other ways to get their hands on the money. So it could really be massively destructive and make business taxation

verging on impossible, but you'd really need a either a fool or a bomb thrower, or both, writing the decision for that to happen, even if you were to specify it's going to be pro-government, pro-tax payer.

Michael Klein
So you don't think that the current Supreme Court has enough fools or bomb-throwers as you put it to eviscerate a third of the tax code?

Daniel Shaviro
Yeah. Again, I think Thomas and Alito might view that with delight, but I think the other conservatives in the court would probably be a little nervous about it. By the way, one funny thing about this is, this is a provision from a Republican tax bill again, 2017 Act, completely a Republican bill. This is their provision, and at the time, absolutely no one raised concerns that it might raise constitutional issues. So it would be kind of the extent that the Supreme Court, that the members of them act like, you know, we like our team better than the other team, it may influence several justices, even if it's actually legally irrelevant, that this is a Republican bill. It wasn't like Elizabeth Warren trying to do something.

Michael Klein
Well, the oral arguments will be heard in December, is that right?

Daniel Shaviro
Yeah, I think 5th or something like that.

Michael Klein
So we'll see what happens with that. This should be interesting. Given the background that I've learned from you, I'm really looking forward to watching that and learning what happens. Dan, I'd like to turn the interview now to a slightly different point of view. Your book, *Bonfire of the American Dream in American Rhetoric Literature and Film*, traces Americans' views of wealth and income inequality through depictions in popular culture. So how do you see the debate over the tax system, especially through features like the graduated income tax, the estate tax, the corporate tax, playing out in popular culture, and do you think the depiction of wealth and income inequality in popular culture spills over into policymaking?

Daniel Shaviro
Yeah, I think it does. I think Americans have always been ambivalent about the rich. Where in the one hand, there's a sort of American dream and the claim that they are the most talented people and they deserve it, and that's why they succeeded, versus viewing them as having possibly cheated or something like that. There's always been kind of an egalitarian theme in American culture, but also a glorifying the market theme. The rich people kind of win on one, and they lose on the other. It's kind of on the one hand in affronts to egalitarianism. On the other hand, a great reward for meritorious achievements. Americans have always been super ambivalent about it. One thing that's funny is that you'd think that the rich would be more unpopular when they're doing very well, because then they're kind of pulling away from everyone and exercising more powerful. But it seems to be the case instead that the rich are more unpopular when they're doing badly. So I have in my book, just for fun, I have a chapter where I

talk about the movie *It's a Wonderful Life* with Jimmy Stewart, which was written and released in 1946, but it's very much set in the Depression era, kind of. And then *The Wolf of Wall Street* with Leonardo DiCaprio, which is sort of set in modern times. And there's much more anti-rich sentiment in the Depression when rich people were actually losing ground, even relative to everyone else then and today. It makes them very glamorous and successful. Even if you just look at something like Trump or Sam Bankman-Fried or whomever, there's a combination of fascination and admiration with rich people, with kind of resentment of them. So it's a very mixed bag and the cultural themes kind of go back and forth, because both loving the rich and hating the rich is very rooted in American culture.

Michael Klein
What do you see going on most recently? There was clearly, like you said, in *The Wolf of Wall Street* quite recently in the last decade or so, there was this glorification. And then going back more than a decade, there was the financial crash in 2008. It seems to me like there is a lot of concern about the rich at that time. COVID, I'm not sure what would have happened with the view of income inequality. But what do you see in the last, say, 10, 15 years about the popular culture's depiction of income inequality and the very wealthy?

Daniel Shaviro
Well, I think the sort of view of them as a little bit villainous has maybe quite [inaudible]. There are billionaires who are both loved and hated. Or someone like Elon Musk, it seems like he's made it his personal mission to debunk the idea that rich people are smart, and know what they're doing by acting like a complete fool, buying something for $45 million, then torching two-thirds of its value overnight and just [inaudible] fighting with people. But on the other hand, he has his admirers too. So I think the financial crisis made a difference because in 2008, because if kind of there they, you know, bring prosperity to us all, it's a lot more easy to, you know, sign on to the program, so to speak. But if they start being seen as villains, or as stealing money from the rest of us or something like that, then that becomes politically fraught territory for them. But still, there's just so much, not only do rich people have so much influence like money and politics, but culture, kind of 'Lifestyles of the Rich and Famous' ethos, even though I don't think that show is on anymore – gives them a lot of cultural as well as political and economic power.

Michael Klein
Dan, thank you very much for speaking with me today, both about the intricacies of these tax codes and the Moore case, which could have very big implications. And also about your recent book about the views of income inequality and wealth in American popular culture, and sort of showing how these two are very closely interrelated. It's great to have you on the show.

Daniel Shaviro
Well, thanks. It was great to be here.

Michael Klein
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