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Tax Features

Moscow Business Conference Addresses International Taxation and Basic Economics in Former Soviet Union

Over 700 business men and women and government officials, 300 American and 400 Soviet and Russian, attended the Moscow Business Conference, which the Tax Foundation co-hosted at the Kremlin December 1-7. Foundation Cochairman James C. Miller III led the American participants who included Ambassador Robert Strauss, Secretary of Labor Lynn Martin, Deputy Secretary of the Treasury John Robson, publisher of *Fortune* magazine James Hayes, and former Secretary of Transportation James Burnley. Soviet and Russian participants included President Boris Yeltsin, President Mikhail Gorbachev, Yegor Gaidar, Deputy Prime Minister for Economic Affairs, Russian Republic; and Arkady Volsky, Deputy Chairman, Committee for the Management of the National Economy.

Tax Foundation Co-Chairman James C. Miller III applauds Russian President Boris Yeltsin after his presentation in the Great Hall of the Kremlin Palace.

Historic developments during the week of the conference including the floating of the ruble and the announcement as the conference adjourned on Sunday, December 7, of the new Commonwealth's formation. A small group from the conference met Saturday with Gorbachev who was quite bitter about the failure of the Republics to enter into the Union Treaty.

A positive attitude towards Western investment was underscored by President Yeltsin's

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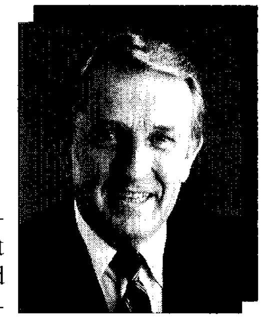
FRONT BURNER

Tax Policy Should Attract Venture Capital to Small Business



Sen. Dale Bumpers

Shortly before Congress left town last year, I introduced legislation to reduce the capital gains tax rate on long-term investments in American small business ventures. I have been joined in this legislation by 44 co-sponsors in the Senate, and companion legislation has been introduced in the House of Representatives by Representatives Bob Matsui (D-CA), Jim Moody (D-WI), and Bill Gradison (R-OH).

Unlike other capital gains proposals, my legislation is targeted specifically to new, long-term investments in high-risk small businesses. Moreover, to qualify for the incentive, investments would have to be held for at least five years.

The legislation I have proposed would set up incentives for two categories of investment: investments in the stock of firms with $100 million or less in paid-in capital, and investments in firms with $5 million or less in paid-in capital.

For direct investment in the stock of firms with $100 million or less in paid-in capital, there generally would be a 50 percent tax deduction. The maximum capital gains tax rate would be 14 percent for taxpayers in the 28 and 31 percent personal income tax brackets. The maximum rate for individuals in the 15 percent tax bracket would be 7.5 percent. In order to qualify for these reduced tax rates, stock would have to be held for at least five years. The excluded gains would be a tax preference item for purposes of the minimum tax.

For investments in firms with $5 million or less in paid-in capital, the capital gains tax rates would be reduced further on a sliding scale if

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Senator Dale Bumpers, Arkansas Democrat, is Chairman of the Senate's Small Business Committee.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

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the stock is held for six years or more. For such stock that is held for ten years or more, there would be a 100 percent capital gains deduction. The minimum tax would not apply to capital gains realized on those investments.

The thrust of this legislation is to reward investors and entrepreneurs who are willing to take risks and invest for long-term economic growth, not short-term income.

The thrust of this legislation is to reward investors and entrepreneurs who are willing to take risks and invest for long-term economic growth, not short-term income. It calls upon investors to change their portfolio strategy rather than simply rewarding them for doing exactly what they are already doing without any capital gains tax incentive for doing so.

The capital gains incentive provided by my legislation is directly related to America's competitiveness challenge. This is because it would only apply to high-risk, long-term, growth-oriented investments in businesses that will create the

The capital gains incentive provided by my legislation is directly related to America's competitiveness challenge. This is because it would only apply to high-risk, long-term, growth-oriented investments in businesses that will create the technology and jobs of tomorrow and that will help the United States compete in international markets.

technology and jobs of tomorrow and that will help the United States compete in international markets. This legislation looks to the future, both in terms of the policies of the Congress and the nation and in terms of its emphasis on investments that are critical to help America compete in international trade.

I must be candid in acknowledging that the investment incentive that I have proposed does lose revenue. Thus, I will insist that the revenue loss be financed on a pay-as-you go basis under the 1990 budget reconciliation law.

I am well aware that those of us who propose tax incentives for savings and investment cannot claim that we have increased savings if we increase the federal budget deficit to pay for it. This would be a zero sum game with the increase in private savings being cancelled out by the decrease in public savings. The key issue is whether we have increased public and private savings on a net basis.

[Since] we have limited discretionary revenue, we must set our priorities very carefully. . . . An incentive for venture and seed capital formation should form the core of any capital gains legislation considered by the Congress.

According to the Joint Committee on Taxation, my legislation would lose approximately $900 million over a five-year period. While this is not an insignificant amount, the revenue loss is small enough that we do not need to raise tax rates on ordinary income or to impose a surcharge on wealthy taxpayers to pay for it. The potential revenue loss associated with my proposal also pales in comparison to the capital gains proposal advanced by President Bush during the 1990 budget summit negotiations, which would have lost $11.4 billion in revenue over a five-year period.

In conclusion, I would like to point out that in an age in which we have very limited discretionary revenue, we must set our priorities very carefully. In terms of priorities, an incentive for venture and seed capital formation should form the core of any capital gains legislation considered by the Congress.

These high-risk, long-term, growth-oriented forms of direct investment are the stimulus our ailing economy needs.

Tax Compliance Issues Aired at Foundation Seminar

Floyd L. Williams, III, chief tax counsel for the Tax Foundation, set the background for the corporate tax compliance seminar by explaining the Foundation's interest in the subject. "One of the Foundation's guiding principles is that the nation's tax system should be as simple as possible because a complicated system imposes a heavy cost on society and undermines compliance. One way we are trying to achieve this objective is through a study now in progress by Professor Joel Slemrod of the University of Michigan. The hope is that he will be able to put a price tag on complying with various tax provisions, either proposed or existing."

Williams then introduced the panelists who were divided into participants from government and industry. John Monaco, Executive Director of the Coordinated Examination Program of the Internal Revenue Service; Scott McLeod, a legislation counsel with the Joint Committee on Taxation of the U.S. Congress; and Robert S. Winters, Legislative Director and House Budget Committee associate staff member to Congressman Bill Thomas (R-CA) comprised the govern-

John Monaco, head of the IRS's Coordinated Examination Program. To his left is Scott McLeod, Joint Committee on Taxation.

ment panel. J.P. LaCasse, Director of Taxes, American President Companies, Ltd.; J. Peter Campagna, Tax Compliance and Planning Manager, Intel Corporation; Patricia Margaret Kaitz, Director of Taxes and Tax Counsel, Nellcor Inc.;

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Compliance from page 2

Richard C. Lam, Manager – Tax Audits, Chevron Corporation; and Steven Rosner, Manager of Tax Analysis, Pacific Telesis Group were the five industry panelists.

Monaco, who led off, is ultimately in charge of compliance for America's 1,600 largest corporations. His statements are carefully watched by top tax executives such as those present on the panel and in the audience, so his comments were guarded, avoiding any discussion of specific code problems. But he described an encouraging new philosophy of compliance the IRS has recently adopted, which he called Compliance 2000.

J.P. LaCasse, Director of Taxes, American President Companies, Ltd., and Patricia Kaitz, Director of Taxes, Nellcor.

"Six goals of the program are as follows: (1) Make the tax administration systems and laws more conducive to corporate taxpayers determining the proper amount of tax with the filing of their returns and less from the audit process; (2) Relieve taxpayer burdens through tax simplification and improved systems and procedures; (3) Resolve most factual issues at the examination level; (4) Provide proper and timely training and resources to all employees; (5) Improve the effectiveness and efficiency of the examination process; and (6) Substantially improve the timeliness of examinations.

Monaco fielded questions about the statute of limitations, the possibility of giving agents settlement authority, the role the IRS has played and is expecting to play in legislation, and the changes necessary to make our tax laws and procedures easier for corporate taxpayers.

J.P. LaCasse of American President Companies did not hesitate to delve into specifics. "The effort required for us to go through our tax depreciation calculation has more than doubled," said LaCasse. "The alternative minimum tax (AMT), designed to penalize an overly aggressive use of tax deductions, has in reality imposed a tax increase on companies who can least afford it — companies with lower profits due to the recession."

On the foreign tax credit issue: "The 1986 Tax Reform Act, the same legislation which inaugurated the AMT, radically changed the method that we must use to calculate our foreign versus domestic sources of income," said LaCasse. "But despite this radical change, there have been no regulations issued since 1986 on the code section that is applicable to us."

LaCasse briefly mentioned a favorable recent experience — his company had an audit of two tax years which lasted only seven months

J. Peter Campagna of Intel restricted himself to a very specific area: passive foreign investment companies, or PFICs. Never intended to be a loophole closer aimed at corporate taxpayers, the creation of PFICs was supposed to close down offshore mutual funds that allowed taxpayers to defer the income tax on essentially moneymarket deposits that they were making until they actually sold the shares.

After retelling the provision's history, Campagna submitted these suggestions:

- Where the taxpayer is already filing Form 5471, remove all the other PFIC reporting requirements.
- Eliminate duplicate filing requirements.
- Define a company's start-up year as the first year it has positive gross income.
- Make the determination of a PFIC on a qualified business unit basis, rather than corporation by corporation basis.

Comments from the corporate panel continued with Patricia Margaret Kaitz, of Nellcor Inc., raising the concerns of the small-to-medium sized company. "Sometimes we just throw up our hands and say that with the limited staff we have, we can't comply with some of the regulations, as complex as they are," Kaitz declared. "A company our size, about $158 million, files 800 returns, and I hope the people on the Hill will listen and understand that we hope someday to be a very large corporation, but we need to do so by growing and marketing our products internationally, not by growing a tax department."

Richard C. Lam of Chevron Corporation confessed that much of the delay in the audit process is a by-product of corporate growth. "By acquiring other companies, we end up with new accounting systems and new record systems. We inherit the old problems. . . . There is absolutely no reason we should spend 80 percent of our audit time trying to reconstruct records, and 20 percent of the time dealing with the issues. It ought to be the other way around."

On the IRS's side, Lam said, "Agents and case managers must be convinced that they don't need to see every invoice within an account, and that they don't need to analyze every account. Formal document requests and designated summons have become such a powerful tool in the hands of the Service that some of the former give-and-take in the audit process is denied to the taxpayer."

Steven Rosner of Pacific Telesis Group seconded Kaitz's point about the cost of compliance eating up a disproportionate share of corporate resources. "When I started out in the foreign tax area in 1981, I actually did an IRC Sec. 861 calculation allocating expenses between foreign and domestic sources on an eight-column sheet of paper — by hand. Now we spend thousands of dollars on computer software, accounting firms, and legal fees, and we also drain management's time trying to figure out our foreign source allocation. To what end? We are spending time worrying about this rather than trying to expand abroad."

Patricia Kaitz of Nellcor speaks with Richard C. Lam, Manager – Tax Audits, Chevron Corporation, at her left.

After these remarks from the corporate panel, Scott McLeod of the Joint Committee on Taxation noted that tax staffers on Capitol Hill are indeed sensitive to corporate compliance burdens,

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Long-Awaited Corporate Integration Study Released by Treasury

The Treasury Department released its long-awaited study on corporate integration on January 6. The study asserts that integrating the corporate and individual tax systems is desirable and should be given serious consideration. Titled *Integration of the Individual and Corporate Tax System, Taxing Business Income Once*, the report makes no legislative recommendations but instead outlines four prototype integration systems and details how each would work.

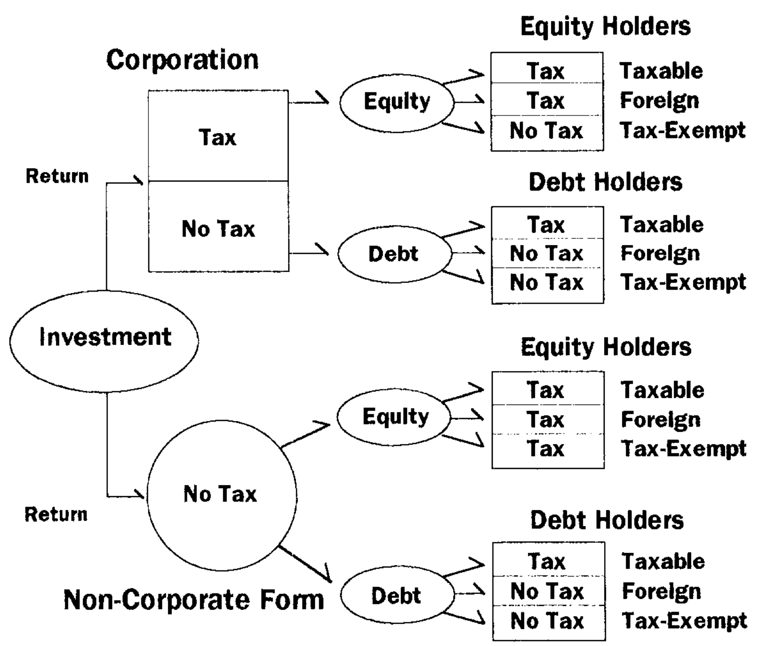
Current U.S. tax law treats corporations and their individual investors as separate entities and levies a tax at both the corporate and shareholder levels on earnings from investments in corporate equity. Therefore, corporate income is subjected to taxation at least twice — once at the corporate level and once at the shareholder level. In fact, corporate profits may be taxed more than twice if they are distributed through multiple unrelated corporations. Stated simply, integration of the individual and corporate income tax refers to the taxation of corporate income only once.

The importance of examining an integrated U.S. corporate tax system has been heightened by the integration of corporate and shareholder taxes by most of our major trading partners over the past two decades. The primary objective of this integration has been to mitigate the impact of imposing two levels of tax on distributed corporate profits and to reduce the cost of capital for corporate investments. Integration has been most commonly accomplished by allowing the shareholder a full or partial credit for taxes paid at the corporate level.

Corporate integration would attempt to reduce basic distortions created by the current tax treatment of corporate profits, which include: (1) the incentive to finance corporate investments with debt rather than new equity, (2) the incentive to retain earnings or to structure distributions of corporate profits in a manner to avoid the double tax, and (3) the incentive to invest in noncorporate rather than corporate businesses (see figure).

The Treasury report offered four integration prototypes: (1) the dividends exclusion method, (2) the shareholder allocation method, (3) the comprehensive business income tax method (CBIT), and (4) the imputation credit prototype (see table on page 5). The integration method most favored in the study is the dividends exclusion model primarily because it could be implemented with minimal changes to the current law.

Distortions Under the Current Corporate Income Tax[1]



[1] The figure does not take into account tax preferences or taxes imposed by other countries.
Source: U.S. Department of the Treasury

Generally, under the dividends exclusion prototype, corporations would continue to calculate their income under current law and pay tax at a 34 percent rate. Shareholders receiving corporate distributions treated as dividends under current law, however, generally would exclude the dividends from gross income. The dividends exclusion method requires corporations to keep an Excludable Distribution Account (EDA) to measure the amount of dividends that can be excluded by shareholders, which would basically represent the amount on which corporate taxes have been paid. Basically, the dividends exclusion method would apply the 34 percent corporate tax rate to both distributed and retained income but would eliminate the shareholder level tax on dividends paid from fully-taxed corporate income.

In addition to outlining four prototype integration systems, the report makes several basic policy recommendations that should be part of any integration proposal ultimately adopted. These include (1) integration should not result in the extension of corporate tax preferences to shareholders, (2) integration should not reduce the total tax collected on corporate income allocable to tax-exempt investors, and (3) integration should be extended to foreign shareholders only through the treaty negotiations, not by statute (this is to assure that U.S. shareholders receive reciprocal concessions from foreign tax jurisdictions).

Although different methods of integration are outlined in the Treasury study, they reflect a common goal: to allow fundamental economic considerations rather than tax code considerations to guide business investment, organization, and financial decisions. For example, the Tax Reform Act of 1986 made the tax system significantly more neutral in its impact on business decisions about capital investment by reducing marginal tax rates. The 1986 Act however, did not address tax code distortions of business organizational and financing decisions. Thus, Treasury suggests that corporate integration may be regarded as a second phase of tax reform for the U.S., extending the goals of neutral taxation to the choice of business organization and financial policy.

The primary goal of integration is to improve economic efficiency by enhancing neutrality in the taxation of capital income. Treasury's report suggests that four goals should be incorporated in the design of an integrated tax system: (1) integration should make taxation of investments across the various sectors of the economy more uniform, (2) integration should make more uniform the taxation of returns earned on alternative financial instruments, particularly debt and equity, (3) integration should reduce the distortions present in the choice between retaining and distributing earnings, and (4) integration should create a system that taxes capital only once.

With the increased integration of international markets for products and capital, the corporate tax system must allow U.S. firms to be internationally competitive. While this current corporate integration study will prompt congressional tax committee hearings this year, any legislative action is likely to be years down the road. ■

Comparison of the Four Principal Integration Prototypes

	Prototype			
Issues	**Dividend Exclusion Prototype**	**Shareholder Allocation Prototype**	**CBIT Prototype**	**Imputation Credit Prototype**
Rates				
a) Distributed Income	Corporate rate	Shareholder rate[1]	CBIT rate (31 percent)	Shareholder rate[1]
b) Retained Income	Corporate rate (additional shareholder level tax depends on the treatment of capital gains)	Shareholder rate	CBIT rate (additional investor level tax depends on the treatment of capital gains)	Corporate rate (additional shareholder level tax depends on the treatment of capital gains)
Treatment of non-corporate businesses	Unaffected	Unaffected	CBIT applies to non-corporate businesses as well as corporations, except for very small businesses.	Unaffected
Corporate tax preferences	Does not extend preferences to shareholders. Preference income is subject to shareholder tax when distributed.	Extends preferences to shareholders.	Does not extend preferences to investors. Preference income is subject to compensatory tax or investor level tax when distributed.	Does not extend preferences to shareholders. Preference income is subject to shareholder tax when distributed.
Tax-exempt investors	Corporate equity income continues to bear one level of tax.	Corporate equity income continues to bear one level of tax.	A CBIT entity's equity income and income used to pay interest bear one level of tax.	Corporate equity income continues to bear one level of tax.
Foreign source income	Foreign taxes are creditable at the corporate level, but shielded income is subject to shareholder tax when distributed.	Foreign taxes are creditable at the corporate level and at the shareholder level.	Foreign taxes are credit–able at the entity level, but shielded income is subject to compensatory tax or an investor level tax when distributed.	Foreign taxes are creditable at the corporate level, but shielded income is subject to shareholder tax when distributed.
Foreign investors	Corporate equity income continues to bear tax at the corporate level and current withholding taxes (eligible for treaty reduction) continue to apply to distributions.	Corporate equity income continues to bear tax at the corporate level and current withholding taxes (eligible for treaty reduction) continue to apply to distributions.	A CBIT entity's equity income and income used to pay interest bear tax only at the entity level, and no withholding taxes are imposed on distributions to equity holders or on payments of interest.	Corporate equity income continues to bear tax at the corporate level and current withholding taxes (eligible for treaty reduction) continue to apply to distributions.
Treatment of debt	Unaffected	Unaffected	Equalizes treatment of debt and equity.	Unaffected (unless bondholder credit system adopted)

[1] Plus 3 percentage points of corporate level tax not creditable because the prototype retains the 34 percent corporate rate but provides credits at the 31 percent shareholder rate.

Source: U.S. Department of Treasury

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then focused on specific legislative proposals pending in Congress.

McLeod said that proposals which have the support of the Administration, and which he thinks could be included in any tax bill this year, include:

- Simplifying the method of calculating depreciation for purposes of the corporate AMT.
- Simplifying calculations required under the uniform capitalization rules.
- Consolidating the various anti-deferral regimes: the PFIC rules, the foreign personal holding company rules, and others.

He then turned to the amortization of intangibles. "In order to eliminate various disputes, Chairman Rostenkowski's bill, HR 3035, would apply a uniform 14-year period to most . . . purchased intangibles, eliminating the disputes with the Service over whether the assets are separate and distinct from goodwill and going concern value. It will also eliminate the disputes concerning how much of the purchase price is allocable to any particular intangible."

Anticipating protests about the 14-year provision from the software executives in the audience, McLeod explained,

Joel Slemrod, Professor of Business Economics and Public Policy at the University of Michigan, has undertaken a comprehensive study of corporate tax compliance costs for the Tax Foundation.

"[The result] is draconian when you apply it to software that is purchased off the shelf. But . . . if you are acquiring a trade or business and one of the assets happens to be a very good software system, the taxpayer may attempt to allocate a large portion of the purchase price to the software."

He tried to offer more hope on that score by saying the proposal was deliberately drafted broadly because it is easier to take a provision out than to add it later.

Robert S. Winters of Congressman Bill Thomas's office stated flatly to the audience that there doesn't seem to be any strong constituency right now for simplification.

As an example, he noted that the passive loss rules that have been a major concern of Congressman Thomas are estimated by the Joint Tax Committee to bring in $5 billion, and Winters thinks that to do something about them under the pay-as-you-go regime would require corporate surcharges or a higher AMT rate.

Winters closed by urging corporations to come to legislators as often as possible with ideas for simplifying corporate tax compliance — but also to come with ideas for evening up the federal till if the simplification measures they want will reduce federal revenue.

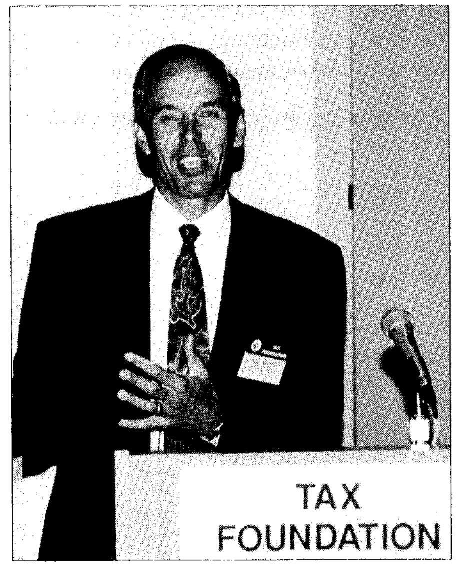
Moderator Floyd Williams then introduced Professor Joel Slemrod, Professor of Business Economics and Public Policy at the University of Michigan and Director of the Office of Tax Policy Research at the School of Business Administration. Slemrod has undertaken a comprehensive study of corporate tax compliance costs for the Tax Foundation.

Slemrod acknowledged the difficulty of keeping tax simplification on the policy agenda but thinks one way to keep it there is to develop the kind of quantitative measures of complexity's cost that have been developed for the other two goals of the tax system, equity and efficiency.

He asserted that there has not been a definitive study of tax complexity's cost in the United States. "The study for the United Kingdom came up as 0.52 percent of revenue collected."

He went on to criticize the best-known compliance study in the U.S., commissioned by the IRS and done by a consulting firm, Arthur D. Little, principally for not examining enough big businesses.

Slemrod proposes a survey methodology for his study, starting with a small number of corporations, then developing a survey to send to over 100 corporations. He plans to use the results of these 100 surveys to make a model of the cost of complexity. He passed out copies of the pilot draft of the study, so that those interested in providing feedback



Luncheon speaker Robert P. Wayman, Chief Financial Officer, Hewlett-Packard Company.

could do so.

Robert P. Wayman, Chief Financial Officer, Hewlett-Packard Company, spoke at the luncheon following the event. He compared the U.S. with its fast-growing competitors and sounded the theme of our need to compete effectively in a global marketplace. In this context, he cited taxes as a cost of doing business, with tax compliance as part of that cost.

"We sent a team over to Japan to visit four or five Japanese companies about their finance costs. Some didn't have good information, so we used head counts to give some indication of their finance costs compared to ours," said Wayman. "The largest tax department encountered in these Japanese companies was five people. Ours has 50 people.

"Japanese companies' tax returns are typically completed within two weeks of their statutory accounts," Wayman continued. "And they generally have a two-to-three week audit every couple of years."

Wayman touched on a host of other specific compliance issues: controlled foreign corporations, the 20 percent meals deduction disallowance, auto recordkeeping requirements, records retention, the foreign tax credit, PFIC rules, and many others. ■

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address to the conference on Wednesday. He reaffirmed his commitment to create a hospitable environment in the areas of tax law and property rights to attract foreign investment.

Fortuitously, the two panels organized by the Tax Foundation to address "The Philosophy and Economics of Taxation" and "The Technical Aspects of Taxation" were conducted one day before tax legislation came before the Supreme Soviet of the Russian Federation. The U.S. faculty included John E. Chapoton, managing partner, Vinson & Elkins; Ernest S. Christian, Jr., partner, Patton, Boggs & Blow; Dr. Charles E. McLure, Jr., senior fellow, Hoover Institution; Glenn W. White, former director of taxes, Dow Chemical Co.; Bruce S. Brown, vice president of taxes, Philip Morris Companies, Inc.; Harrison Cohen, legislation counsel, Joint Committee on Taxation; Edward Lieberman, partner, Cole Corette and Abrutyn; and Phil Morrison, international tax counsel, U.S. Department of the Treasury.

Russian President Boris Yeltsin addresses the Moscow Business Conference. The image of the hammer and sickle emblazoned on the podium would be a relic within a month of his speech.

Russian participants included Vladimir Scherbakov, cochairman of the conference and president of the Foundation for the Support of Privatization; Andrey Shapovaliantz, Deputy Minister of Finance and Economics; and Viktor Tuhr, Head of Taxation Department, RSFSR Ministry of Finance. Messrs. Shapovaliantz and Tuhr are the principal architects of the new tax law of the Russian Federation; Tuhr is charged with negotiating a tax treaty with the U.S.

The Americans essentially agreed on every important topic. The features of an ideal tax system, based on years of experience in legal practice, international corporate practice, and public policy involvement, were as follows:

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FOUNDATION MESSAGE

In the U.S. – Simplify the Tax Code; In Russia – Make It Simple from the Start

Dan Witt
Executive Director

The Foundation understands that any tax system, whether here in the U.S. or in the new nations of what was the USSR, will always reflect trade-offs in achieving such objectives as simplicity, stability, efficiency, fairness, and economic growth. We do believe, however, that sound principles of taxation should be observed in making those trade-offs.

In the case of the U.S. tax code, simplicity has taken a back seat to practically everything, with the result that our code is a maze from which even experienced corporate taxpayers rarely emerge unscathed. For people contemplating a new business venture, the fear engendered by the IRS and its labyrinth of regulations keeps many potential investors out of the marketplace altogether.

The Tax Foundation kept code simplification issues alive with its seminar on corporate tax compliance December 4th in San Francisco (see page 3). John Monaco, who supervises the IRS's examination of the nation's top corporations, conveyed a positive message with his discussion of the service's new philosophy of compliance. If implemented according to the spirit of his remarks, the new approach, which he calls Compliance 2000, would be a welcome change.

Professor Joel Slemrod, who is authoring a study for the Foundation on corporate tax compliance cost, reminded the audience that in 1984, the Treasury's reform proposal called for fairness, simplicity, and economic growth. In 1985, simplicity slipped to third place in a proposal that demanded fairness, growth, and simplicity. But in final form, the Tax Reform Act of 1986 made no mention of simplicity. With a series of studies and programs, the Tax Foundation hopes to put simplicity back into the vocabulary of Washington taxwriters.

At the same time as corporate executives and government officials confronted the morass of U.S. tax code provisions in San Francisco, the Tax Foundation was sponsoring the Moscow Business Conference in the Kremlin (see page 1). There, instead of trying to remedy an overly complex tax system, the mission was to prevent the creation of a new one.

Foundation Cochairman James C. Miller III led the American faculty, all of whom stressed the vital importance of establishing a relatively simple tax system in Russia and the other republics. From a strictly practical viewpoint, the former USSR's lack of experience with tax compliance and administration is a compelling argument against a complicated tax system.

Complexity absorbs scarce resources and undermines the perception of fairness under the best of circumstances. A direct tax based on consumption, rather than income, was proposed for this reason, as well as for its promotion of capital formation.

How can the Tax Foundation make valuable contributions in venues as far removed as the highly developed field of U.S. corporate taxation and the creation of new capitalist economies in the former USSR? By maintaining objective standards, and by holding all tax systems up to the sound principles of taxation which have made the Tax Foundation a reliable benchmark in the field of tax research for over 50 years.

In Moscow during the changing of the guard: Secretary of Labor Lynn Martin (l.), Tax Foundation Cochairman James C. Miller III (c.), and Foundation Executive Director Dan Witt hold up a spread of news magazines heralding the triumph of Boris Yeltsin.

James C. Miller III, cochairman of the Moscow Business Conference addresses the assembled faculty and delegates. From left: Yegor Gaidar, Deputy Prime Minister for Economic Affairs, Russian Republic; Russian President Boris Yeltsin; and Vladimir Scherbakov, conference cochairman.

- it is fairly simple to administer and comply with;
- it is stable, promoting investment and long-range tax planning by only infrequently changing rules;
- it is neutral, allowing the market to direct investment, favoring neither certain industries nor certain consumer behavior, i.e., saving vs. consumption;
- it is broad-based, with low rates;
- it promotes capital formation by taxing consumption, rather than income;
- any income tax would be creditable.

Tuhr articulated the same goals as the Americans but described important and troubling departures from those principles, including exemptions for profits invested in the production of food, medicine, and selected consumer goods, exemption of the profits of small businesses for the first two years of operation, and preferential taxation of foreign-owned enterprises.

One important area scarcely mentioned by the panel was the fiscal relations among (and within) the republics of the former USSR. The chaos that has plagued both horizontal and vertical fiscal relations in the U.S. and efforts at tax harmonization (more recently "tax convergence") that have been ongoing in the European Community since shortly after the Treaty of Rome indicate the importance of dealing satisfactorily with this problem at an early stage. ■

Tax Features

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Co-Chairman .... James Q. Riordan
Co-Chairman .... James C. Miller III
Executive Director .... Dan Witt
Chief Tax Counsel .... Floyd L. Williams
Director of Fiscal Affairs .... Paul G. Merski
Director, Special Studies ... Gregory Leong
Senior Fellow .... B. Anthony Billings
Editor .... William Ahern

Tax Foundation
470 L'Enfant Plaza, S.W.
Suite 7400
Washington, D.C. 20024
202-863-5454

Tax Foundation
470 L'Enfant Plaza, S.W.
Suite 7400
Washington, DC 20024