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Transparency and Taxation

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I. – Introduction

An unexpectedly partisan political debate over redistributive tax measures has recently come to focus on fiscal transparency. In this debate, fiscal transparency and tax neutrality are often spoken of interchangeably. They are, however, distinct. Tax legislation is neutral if it does not influence economic choices. It is transparent if the public can understand how tax burdens are allocated and the reasons for their allocation. Neutrality and transparency differ therefore not only in their primary focus but also in the types of evidence that may support assertions concerning them. A feature of a tax system can only be said to be neutral *ceteris paribus*, because it is virtually impossible to know in detail how economic behavior will in fact respond to a tax measure. In contrast, average levels of information about how the tax law works provide reasonably firm evidence of transparency. Given these and other conceptual differences, I will argue here that, while the current debate fails to distinguish transparency and tax neutrality adequately, a fruitful approach to fiscal transparency may be implicit in it.

Section II surveys the simultaneous emergence of the industrial revolution, popular democracy, and income taxation in Europe and elsewhere, explaining how the very advantages that favored income as a tax base also created technical difficulties that soon resulted in non-transparent tax design. Section III briefly describes recent political debates in France, the United States, and elsewhere over tax subsidies for social policy ends. Section IV explains how United States experts and politicians have cast doubt on the foundations of the "tax expenditure" analysis of these subsidies. Section V analyzes other reasons for a growing interest in fiscal transparency and argues that talk of tax neutrality in the context of tax expenditure analysis should be replaced with a better focused understanding of fiscal transparency based on the ability of the public to understand complex tax measures. Section VI concludes that transparency provides a better analytical tool for some, but not all, fiscal analysis that now employs the rhetoric of tax neutrality.

II. – The distinctness of tax neutrality and fiscal transparency

The rise of industrialization and democracy made taxation the backbone of the modern state. In earlier times, national rulers and big religions competed with the private sector, owning substantial parts of the resources within their territory, using those resources without accountability, and burdening the base of the economic pyramid, a population that had no say in affairs of state. But industrial democracies today rely on the overt sequestration of resources through taxation, rather than indirect confiscation, largely because they answer to the public, or wish to appear to do so.

Open government is an essential ideal of democracy. People must be able to understand, make judgments about, and generally see what is going on in the corridors of power, for government to have any chance of being representative. What must be transparent? We sometimes speak as if transparency requires governmental *procedures* to be open to public comprehension but requires nothing of substantive governmental decisions. Transparency, we think, is about process, not outcomes. It is certainly true that government is *more* transparent if all concerned can easily see whether it functions in accordance with its own ground rules. This may tempt us to think transparency cannot be an issue for tax design. Current arguments about tax transparency assume, and perhaps also to some extent prove, the opposite: that tax design, even the fine detail of tax laws, may affect transparency.

With greater access by the public to information and sustained economic growth, fiscal transparency became are more demanding goal. Duplicative taxes on consumption goods and private transactions were unpopular because they obscured tax incidence. Governments were instead virtually forced to tax income, the least controversial indicator of well-being, and a common human attribute in the industrial age, rather than land or consumption, which by their nature were more susceptible to multiple taxation. First in Europe and then elsewhere, the desire for transparency favored broad direct taxes (Orsoni 1995, p. 29-30). Economics, the "dismal science," owes its existence in part to the desire of early economists to explain fiscal matters to their fellow citizens and thereby to pressure legislatures to make better and clearer choices in tax design. (192) Adam Smith, David Ricardo, Jean-Baptiste Say, Pierre-Joseph Proudhon, McCulloch, John Stuart Mill, and virtually all economists of the classical period at the beginning of the nineteenth century devoted roughly a third of their works to clarifying how taxes of various kinds affected the people they burdened and served.

But what had been a solution to a problem eventually became part of the problem. The goal had been to measure the new wealth created by all factors of production – labor, working capital, financial services, passive investment, and combinations of these. In its early days, income in the form of wages, profits, and rents was easily measured, and taxing this common evidence of economic success seemed straightforward. Income could be seen by all to track the disparate parts of the economy even-handedly. But then it became apparent that identifying the costs of producing new income, so as not to tax old income a second time, required complex accounting rules, many of them somewhat or even very arbitrary. Long-lasting equipment and consumption items should not be treated as serving only the period of time in which they were purchased, and so amortization of costs became essential. Deduction of reserves for future outlays, for example in banking and insurance, called for further line-drawing. Sophisticated taxpayers eventually dominated the tax legislative process.

Heavy reliance on tax revenues by states husbanding prosperous and diverse economies made transparency a test for both the design and the enforcement of the income tax. There are two reasons for this. First, the goal of matching tax burdens with *faculté* or ability to pay required an ever more probing analysis of how the economy worked. Second, the intrusiveness of taxation created opportunities for democracy to undercut due process: legislatures could deny rights

(192) In our own time, Geoffrey Brennan and James Buchanan, the Virginia School economists (the latter a Nobel Prize Winner), argued that tax laws might serve a "constitutional" purpose, making government serve popular will better and avoiding Condorcet's paradox of democracy. (Brennan & Buchanan 1980, pp. 1-33, 37; Daunton 2001, pp. 8-10).

in the process of taxing them. Yet non-transparent lawgivers discovered they could cover their tracks by taking advantage of the public's reluctance to find out whether incomprehensibly complex tax rules were inherently or deliberately so. Because information about the distribution of tax burdens is essential for intelligent exercise of democratic rights, tax design and not only the tax collection process had become a proper focus for judgments of governmental transparency.

It is rarely deliberate subterfuge by lawmakers that most seriously undermines fiscal transparency. Sometimes it is the juxtaposition of similar taxes earmarked for the support of distinct social programs. For example, taxes based on *gross* income, like the social security taxes in France (*cotisations sociales* (193)) and the US, make few (in the case of the CSG) or no adjustments (in the case of the US Social Security payroll tax) for attributes of the taxpayer like family size or expenses that contribute to the earning of income. But these are imposed simultaneously and often by the same mechanism, withholding-at-source, with confusing result (Gravelle & Gravelle 2006). Along these lines, the French Ministère de l'Économie et des Finances has carefully formulated a critique calling for the system of tax and transfer payments for social protection to be made simpler, from both the perspective of the beneficiaries of the system and from that of other citizens (DG Tresor 2012). As the Mirrlees Review of 2010 described wage taxation in Great Britain, so can it be said of wage taxation in many countries: "the rate schedule for earnings taxation as a whole is far more complicated than that for income tax alone, because it consists of many different components which do not fit together harmoniously. . . . Once tax credits and benefits are brought into the equation as well, the complexity becomes quite bewildering, and seemingly arbitrary patterns of effective tax rates proliferate" (Mirrlees 2011, p. 108).

Taxes on personal service earnings, however, face none of the difficulties of measuring non-wage income. They are accordingly much simpler than that of the income tax and their incidence is almost perfectly

(193) The two principal social security taxes in France are the *contribution sociale générale* (CSG) and the *contribution pour la remboursement de la debte sociale* (CRDS). The CSG has a very broad base as it applies in principle to earnings and income from wealth. The CSG applies to service compensation income at a rate of 7.5% and to investment income at 8.2%, but it does make adjustments for personal living circumstances, e.g., Codevi, livret jeune, livret A, livret d'épargne populaire). The CRDS is imposed at the much lower rate of .5% of incomes without adjustment for family benefits or housing allowances. Together, however, the tax burden these taxes impose is comparable to that of the US social security tax, which is extremely difficult to avoid, and which makes no adjustment for any personal attribute of employees or the self-employed.

transparent. In this instance, inexorability of enforcement is at least as important for the resulting transparency as the simplicity of the tax design, but the latter is also basic. If there were more adjustments to liability for these taxes, even perfectly transparent enforcement might leave the public guessing as to the incidence of the taxes' burdens. The same is true of consumption taxes like the VAT, except that it runs into problems with consumer durables like houses, private jets, and ambiguous items that both please the user and serve a profit-seeking enterprise. The contrast between simpler income-sensitive taxes and the plenary income tax makes it obvious that what first recommended income taxation has become a hard promise to keep. This leads us to consider how keeping that promise has also become politicized.

Accordingly, there are many fronts on which tax complexity and special provisions for worthy needs and private choices make the combination of income and other taxes less transparent or even wholly non-transparent (Orsoni 1995, p. 29-30, 246-48.). In the next section, however, we consider a narrowly focused literature on tax breaks for apparently personal expenses and losses, which seems to have diverted attention from other problems of tax neutrality and transparency.

III. – Current partisan approaches to neutrality/transparency

In one conspicuous part of the general tax policy discussion, special tax measures for lower and middle-income taxpayers have prompted an unusually elaborate literature, much of it calling for a retreat from fiscal interventionism. The usual charge is that tax expenditures detract from tax neutrality (Parienty, 1997, p. 136-39). For example, some advocate the removal of *la dépense fiscale* in all its forms from French tax laws (Lehérissel 2001), and French ministerial studies of the horizontal equity and efficacy of *l'étât providence* in France partly concur (Batard 2012; Parienty 1995, p. 135-67). These are but a few contexts in which opponents of wealth redistribution have championed the goal of tax neutrality. Theirs is a different sort of concern for transparency, but equally appropriate because transparency is of course instrumental to the preservation and extension of the programs at issue. I will describe a similar range of transparency and neutrality criticisms in the US in the next section.

It should first be noted that tax neutrality is not a reliable proxy for transparency. Tax expenditures are openly non-neutral. They deliberately reward certain forms of behavior. A brazen departure from neutrality can, in some circumstances, detract from transparency – for example, when the public so takes this departure for granted that it forgets that it *is* a departure – but initially, and in the light of how today's governments report their finances, tax expenditures remain fairly conspicuous. There is little danger that they will trick politicians or the public into misunderstanding their relation to the basic taxing function of government. Their long-term presence, however, can render them invisible to ordinary taxpayers, resulting in secondary non-transparency.

Tax expenditures are also not always devoted to providing a social safety net. Many of them are designed to stimulate the economy or to provide targeted competitive advantages for particular industries. In other words, they can be part of a Keynesian strategy of economic fine tuning. These tax expenditures naturally escape the notice of partisan critics of social insurance, who are also often business lobbyists.

In contrast with the relatively open subsidy some tax expenditures provide, the French and US tax systems, like many others, includes permanent incentives for investment by businesses in certain kinds of equipment, which are tax expenditures because they result in a mis-measurement of business profits (Orsoni 1995, .p 92-98). There is a clear parallel in the "accelerated cost recovery system" (ACRS) put in place in 1981 as part of President Reagan's aggressively stimulative first amendments of the income tax (Utz 2011, p. 228-34). These non-neutral elements are highly non-transparent, even when attention is called to them, because one must understand the effect of early deduction of costs on the nominal tax rate applicable to an enterprise, in order to see that they stimulate business activity by reducing the effective tax rates on the profits of that activity.

It is beyond my expertise to assess the merits of the French neutrality debate. One wonders whether the contributors from the left and the right are even talking to each other. The values the opposing voices celebrate, however, have less to do with neutrality and more with transparency, and in that regard there is an almost perfect parallel between the French debate and that in the United States.

IV. – Recent US debate over tax expenditures

In 2002, President George W. Bush's proposed budget included the statement that "the Administration believes that the concept of 'tax expenditure' is of questionable analytic value." This set off a flurry of comment, some purely partisan but some of a more technical nature. It was, after all, a surprisingly technical comment to come from the White House, which must in accordance with 1974 legislation identify all implicit subsidies and incentives that lurk in the facially neutral tax laws of the country. Nonpartisan critics had long since pointed out that to distinguish true tax rules from rules that camouflage subsidies, we must agree on a "baseline," or list of matters to be covered by tax rules that are *not* extraneous to the proper measurement of what is taxable. The baseline used in US tax expenditure analysis has always been disputed, and official attempts to specify it have been incomplete or ambiguous (Bartlett 2001, p. 414-17). Bush's words were nonetheless a political salvo. Most observers understood them as aimed at political opponents who were critical of the generosity of new tax rules favoring manufacturers and intellectual property firms. The following year, his budget contained the milder statement that "[t]he Administration believes the meaningfulness of tax expenditure estimates is uncertain and that the 'tax expenditure' presentation [in the presidential budget] can be improved by consideration of alternative or additional tax bases" (U.S. Budget 2002, p. 95).

It must be noted that the president's budget is only a proposal and that Congress inevitably formulates its own, often very different, budgetary legislation. For this reason, the Staff of the Joint Committee on Taxation, which serves both Houses of Congress and whose traditional role has been to negotiate a compromise between conflicting fiscal legislation passed separately by the two Houses, speaks with greater influence than the president on the subject of tax expenditures (Hungerford 2011). The Joint Committee, as we will see in a moment, has now taken its own stand on how tax expenditures should be identified.

The inventors of the term "tax expenditures," widely used in the US, were Stanley Surrey and Paul McDaniel (Surrey & McDaniel 1985). They came up with it in response to what they believed was nonpartisan confusion in Congress over the nature of incremental changes in the tax laws, primarily in the income tax laws. It seemed to them, or so

Paul McDaniel once told me, that legislators of all parties and interests at the time often misunderstood the nature of tax provisions they enacted, sometimes believing the income tax base had no structural core, so that spending and taxing were not at all distinct functions (Wolfman 1985). In other words, Surrey and McDaniel were concerned with transparency and not with neutrality, or at least not with neutrality alone. Surrey thought all tax expenditures should be expunged from the tax laws, while McDaniel merely advocated making it clear that tax expenditures were subsidies, and not a proper part of the measurement of the tax base.

1. *The choice of the SHS definition of income as a baseline*

The design of the income tax compels us to distinguish rules for measuring income from extraneous rules. This is the baseline problem mentioned earlier essential to the income tax, despite the emphasis they placed on its distinctness from tax expenditures. Strangely, Surrey and McDaniel were reluctant at first to say what they thought the baseline should be. They eventually settled on the Schanz-Haig-Simons (SHS) definition of income, modified in certain respects, as the standard on which "the structure of the income tax proper" rests and as establishing the content of a "normal" income tax system (Surrey 1973, p. 6). Simons, who was not at all concerned with tax expenditures as such but sought to combat the influence of the ability-to-pay doctrine, associated himself with the earlier work of Georg von Schanz and Robert Haig, who had rejected utility-based definitions of income as unacceptably subjective (Simons 1938 *passim*). SHS not only avoids reliance on the welfare economic conception of benefit, it also bravely puts all its eggs in the basket of objective economic power and market valuation. Going well beyond the ideas of Schanz and Haig, Simons defined income as the sum of a person's net savings or investment plus net consumption over a given period of time.

Among the apparent consequences of this definition are: (1) the possibility that total national income will be less than the sum of individual incomes, because the latter may double-count increments of national (Warren 1980, p. 1084), (2) the superiority of accrual measurement of income and the indictment of taxing only realized gains, (3) the inclusion of gifts in the recipients' income, (4) deduction of all losses, whether personal or arising in an income-oriented activity, and (5) inclusion of unwanted benefits in the income of employees and even of members of the public. Simons, without much explanation, excused real-world tax systems from (2). (194)

The U.S. tax policy community has largely revered Simons's work without taking its scathing opposition to utility analysis seriously (Fleming & Thuronyi 2008, p. 450-61; Utz 2002, p. 914-17). Paradoxically, some regard SHS as supporting the utility-based ability-to-pay tradition in income taxation (Graetz 1987; Kaplow 1996). Simons's brain child, de-coupled from its original purpose and meaning, lives on therefore has acquired a meaning he never intended. Some economists think SHS defines *economic* income, and point out that it contrasts boldly with income as defined by the US and many other income tax system (Slemrod & Bakija 2008, p. 58-62).

2. *Grounds for misappropriating SHS as the baseline*

There is one notable reason for the survival of SHS in this totemic rôle. In order to prove his point that utility theory is unnecessary baggage, Simons had to show that an objective view of income corresponded closely to the then current conception of income, embodied in the U.S. income tax laws of the 1920s and in the European income tax regimes that so heavily influenced them. He was clearly thinking of both models, as his long chapter on Prussian and other German tax theorists demonstrated. But his main point of reference was the U.S. tax system of his day. What authority SHS still has, in other words, is just that of a streamlined version of our tax system, as it existed before becoming festooned with tax expenditures.

The modifications that convert SHS income to the very different income that is subject to the US income tax are not trivial. They are nevertheless taken for granted in tax expenditure analysis (Surrey & McDaniel 1985, p. 3-4). The most important departure from SHS is that "unrealized" income from property dealings is not included in the tax base. In most cases, this means that the appreciation of property is not taken into account as income until the owner chooses to sell or exchange the property for cash or other property. Advocates of tax

(194) Simons was similarly casual in his concession that real-world tax systems might, e.g., exclude gifts from income. A close reading of his argument suggests that he wanted to persuade the reader that an objective, as opposed to a utility-based, approach to defining the income tax base was consistent with the broad design of the US income tax had developed in the U.S., even if it should be necessary to "excuse" deviations of actual law from the ideal without giving any reason for doing so. Simons 1938, p. 100, 207-08; Utz 1993, pp. 12-14, 96-99.

expenditure analysis take for granted that other modifications, like the use of arbitrary depreciation schedules for business property, are also faithful to the SHS standard, although Simons and his antecedents said little about this. Today, economists would presumably consider "economic depreciation" to be part of the definition of economic income, although this measure of asset wear-and-tear is probably more rapid than the straight-line method tax expenditure analysis treats as the default norm. A third unmentioned deviation is the SHS definition's failure to notice the time value of costs and profits that are delayed or accelerated or to tax implicit interest and income from the use of investment assets by their owners.

Without attacking SHS as such, Boris Bittker was the first to object that no such norm is universally recognized (Bittker 1969). More recently, others have developed the theme of the non-existence of a normal tax system with further arguments and examples (Thuronyi 1988; Kahn & Lehman 1992; Bartlett 2001). Meanwhile, tax expenditure sympathizer Michael McIntyre advocated a more flexible approach to distinguishing revenue-raising from spending aspects of the income tax (McIntyre 1980). Separately, the Reagan Treasury Department adopted a revised understanding of tax expenditures by specifying a two-part criterion for them, based ostensibly on the work of Seymour Fiekowski (Fiekowski 1980, p. 214), then in the Treasury Department's Office of Tax Analysis. The criterion replaced the notion of a normal income tax with a "reference tax" criterion. It singled out, within the existing tax law, all exceptions to general rules, and then narrowed the field further by counting only those "subsidies" as tax expenditures that could have been assigned to an existing agency other than the IRS to administer.

3. *McDaniel's response to recent criticisms of the tax expenditure doctrine*

Against this background, McDaniel in a recent essay grappled with the details of tax expenditure analysis, arguing still for the normative status of the modified SHS baseline that had been used consistently for decades, and which a 2008 announcement by the Joint Committee Staff threatened to revise significantly (McDaniel 2012). Yet, as he correctly pointed out, the 2008 approach differed only slightly from the older approach, which he continued staunchly to defend. Indeed, there were only two differences.

The Joint Committee on Taxation staff analysis distinguishes two categories of tax expenditure: tax subsidies and "tax-induced structurally distorting" expenditures (T-ISD). On the new approach, a tax subsidy is recognized by two characteristics: as an exception to a general rule of the income tax and as serving a purpose within the scope of another federal agency's mission. But as McDaniel also pointed out, tax credits are never exceptions to general rules, unless every credit is an exception to the general rule that the income tax is a function of taxable income, or in other words, an exception to the general rule that there are no tax credits. In this respect, the new methodology did little to advance the tax expenditure enterprise.

McDaniel also argued that the very description of T-ISD is self-contradictory, because a structural feature of the income tax cannot be a tax expenditure. More interesting for a wider audience is what the new methodology has to say about tax "deferral," the postponement of income taxation of U.S. corporations' controlled foreign subsidiaries' income until repatriation. The JCT Staff Report, implementing the new tax expenditure approach, removed deferral from the 2008 Tax Expenditure Estimates, without specific comment. The distorting effect of deferral is "well known" because deferral is a benefit to U.S. multinational corporations only if their subsidiaries derive income in low-tax jurisdictions. But far more interesting is McDaniel's comment: "In my view, the principal [sic] of capital export neutrality . . . is a much more powerful principle in the international context than is the separate treatment of corporations and shareholders developed primarily in the domestic context" (McDaniel 2012, p. 25). To unpack this a little: McDaniel is arguing that deferral is not structural, because it depends on the recognition of the separateness of corporations and their subsidiaries, which is not justified as a matter of policy for trans-border transactions, but that capital export neutrality does provide a normative and hence presumably structural ground for deferral.

Finally, McDaniel assailed the new approach for subtly importing a normative conclusion into tax expenditure analysis under the mantle of what he considers a non-structural feature of existing U.S. tax law. He may well have the better view of what is structural and what is not. (I would certainly agree with him about the transfer of corporate separateness from the domestic to the international context.) But as his own reference to capital export neutrality reveals, SHS does not help us in classifying this feature of the income tax as structural *vel non*. If the historical longevity of a feature of the income tax is what makes it normative – SHS primarily has history on its side – the long-standing link between deferral and the separateness of parent and subsidiary corporations should pass muster. And so, McDaniel's' response to deferral acknowledged that arguments about normal income tax structure turn on tax policy arguments of another sort, here on the merits of capital import neutrality.

V. – Growing interest in fiscal transparency

Despite the subtlety and care with which sophisticated commentators discuss tax expenditures, differences of opinion have been polite and laconic, generating little heat. But the issues themselves, if my brief survey is correct, have been obscured by the wrong theoretical categorization: tax expenditures are criticized for their non-neutrality, a characteristic they undeniably have, but their real fault is that they render income tax laws non-transparent, not that they destroy their neutrality. Deliberate fiscal interventionism always renders a tax system non-neutral, unless taxpayers decline to use its benefits, because tax expenditures target certain types of economic choice for tax favoritism. What concerns those who criticize tax expenditures is that are hidden from the electorate, even if made public by separate listing in governmental budgets and in nongovernmental organizations' publications like those of the Organization for Economic Co-operating and Development (OECD 2012).

The tax expenditures most often criticized – special tax benefits for home ownership, child-rearing, retirement savings, and so forth – are indeed not straightforward culprits under the rubric of neutrality. Two important examples in the United States, the deductions for medical expenses and for charitable contributions, can be defended as necessary for horizontal equity, i.e., the like treatment of similarly situated taxpayers, because amounts deductible for these purposes are not "preclusively" consumed by the taxpayer (Andrews 1972; Utz 2012, p. 1216-20). If tax expenditures are neutral because they properly play a role in the correct measurement of income, they may still deserve to be criticized as collectively erecting a *hidden* system of benefits (Howard 1997), because their effect on the progressivity of the income tax is obscure to most taxpayers.

For their non-transparency, however, the "usual suspects" among tax expenditures attract more attention from experts than do even better concealed tax breaks for business and investment – again, not only in the United States but in many first-world countries. The non-uniform taxation of business enterprises that use different juridical entities as vehicles is a prime example. Many OECD countries impose lower effective rates of tax on businesses conducted through some types of juridical entity than they do on business directly operated by individuals (OECD 2012; Kozniewski 2011). Some European countries have gone to considerably lengths to ensure that the tax laws do not favor corporate debt financing to equity financing (Gaud 2005), and a small number have made dramatic efforts to unify business taxation and remove rate discrepancies for different types of business entity (de Hosson 2012). But the central fact is that if the effective rate of tax on income of corporations or other juridical entities is lower than that on the most affluent individuals, these entities serve as tax havens for their shareholders, at least if they are not required to distribute their income annually. As tax theorists all know, a tax delayed is a tax reduced, and the tax on a shareholder's interest in the retained earnings of a corporation is delayed and lightened (Kleinbard 2007, p. 167-70).

These highly technical aspects of entity taxation are as well known to experts as the tax breaks for the middle class that attract all the attention in the recent partisan commentary on tax expenditures. Anyone who cares to delve into these matters can be fluent in discussing them after reading a book or two. They all help deprive the income tax of its neutrality. The point, however, is that ordinary voters are extremely unlikely to undertake the small but, for most people, extremely dull course of study necessary to understand them. The problems of the income tax are thus problems of transparency, which just happen to coincide with problems of neutrality.

In practical terms, transparency is not a matter for technical experts but for the general public. It is they, after all, who need to know in order to exercise their democratic rights. A simple example from US tax law will suffice to show how a perfectly explicit rule of tax law can be far from transparent. The US tax code announces the graduated marginal rates applicable to individuals' income in what seems a neutral and conventional manner. (195) The 2002 tax rate reductions were

(195) I.R.C. § 1(a).

roughly 5% per bracket, e.g., the bottom bracket rate dropped from 15% to 10%, and the top bracket from 39.6% to 35%. Given the averaging of the brackets, however, this translated into a larger drop, about .5%, in the effective rate on taxpayers at the low end of the highest (now 35%) bracket than for taxpayers in lower brackets. The tax rate reductions were not transparent – not because they were secret but because the manner in which the previously existing brackets were stated provided an opportunity for deluding the public (Appelbaum & Debeloff 2012).

It is fortunate that this should be the case, because the failure of tax neutrality by real-world income tax systems is universal and, as has been mentioned, comparisons of non-neutrality have no empirical meaning (Shaviro 2010, p. 120-21; Utz 2008). By contrast, transparency is a completely empirical notion, if perhaps hard to assess without elaborate polling of public knowledge. A fiscal system as a whole, or a specific tax measure in isolation, is transparent if most people grasp how it works and how tax burdens are distributed. They may not know whether it leaves sophisticated agents' economic choices alone or changes them, destroying neutrality. But even economic experts have a difficult time identifying and measuring how taxes affect economic behavior. For the voting public, it is only important that the features of the tax system should be plain enough for ready comprehension.

The partial overlap between transparency and neutrality, where tax expenditures are concerned, is misleading. There, the effect on behavior is deliberate and the packaging of incentives and penalties as tax rules is at best only slightly deceptive. It may become more deceptive as these rules become part of the familiar landscape, but to that extent, the same rules probably also disturb neutrality less and less, given the adaption of economic agents across the full economy to what were initially isolated changes in economic choices.

VI. – The Limits of Neutrality Analysis

As we have seen, deliberate interventionism is not the only means by which tax neutrality can be lost. Income tax systems are particularly vulnerable to non-neutrality with respect to debt and equity interests in business ventures. It is relatively easy, but not costless, for investors in a business enterprise to disguise part of their investment as loans. That they do in fact do this accounts for a significant amount of investment banking activity. Tax authorities, however, must struggle to prevent the distinction between debt and equity, in order to treat interest on loans to businesses differently from distributions of profits to the owners of a business. (196) Otherwise, capital-intensive businesses (with their greater ability to deduct "interest" on loans from owners) would enjoy a tax advantage in their competition for investors' money over other businesses, like those in the service sector. Neutrality thus requires that debt and equity be treated differently but also that taxpayer response to this should be curbed. In other words, to prevent taxpayers from changing their behavior in reaction to the tax law, the tax law must intervene to prevent a different kind of reactive behavior.

In this struggle over debt and equity, all income tax systems lose their neutrality. The costs the tax law inflicts on the private sector appear to be substantial deadweight losses. (Actually, we cannot be sure, and so we do not know that the tax law is non-neutral in this regard; most observers believe treatment of debt and equity is non-neutral.) Tax experts nevertheless think that some tax systems find better solutions than others to this problem. "Better" in this context must mean something like "less non-neutral." Unfortunately, there is no way to measure this. The measurement of degrees of neutrality or its opposite is a theoretical chimera. It is possible for economic models to show us what neutrality would look like, if we knew all the consequences of every economic agent's behavior, but we do not and cannot get that information about the real world (Shoven & Whalley 1992). The economic models show us a Platonic ideal that we cannot operationalize.

A system can be more or less transparent, but we have no metric for saying that a system can be more or less neutral (Utz 2008). From this, it follows in part that we cannot speak on any but intuitive, non-empirical grounds, of improvements in the neutrality of a tax system. Because transparency is a question of how easily the public and others can understand a tax system's consequences, comparative degrees

(196) In France dividends are not deductible by entities that pay them but that the shareholders or other owners are allowed to exclude from their income 40% of the dividend amount. This achieves a kind of integration of the tax burdens of entity and owner, but it leaves the better treatment of loans to an entity intact. The French tax authorities must find other ways to deter owners from disguising contributions to corporate capital as loans. In the US, the government tries to distinguish debt from equity on a case by case basis, but the result is haphazard because of the sheer complexity of this enforcement strategy (Shaviro 2010, p. 35).

of transparency are not as empirically obscure as neutrality, or *a fortiori* comparative levels of neutrality.

VII. – Conclusion

The difficulty of the empirical assessment of tax neutrality makes it inevitable that we sometimes fall back on tax transparency as a proxy. Others and I have argued elsewhere that neutrality is well-defined only within economic models and that the real-world offers no natural metric for degrees of neutrality (Beltrame & Mehl 1984, p. 314-15; Orsoni , p. 247; Shaviro 2009, p. 120-22; Utz 2008). By contrast, transparency is a completely empirical notion, which we can assess with different levels of confidence by simply polling the public concerning their understanding of the law. A fiscal system as a whole, or a specific tax measure in isolation, is transparent if most people grasp how it works and how tax burdens are distributed. They may not know whether it leaves sophisticated agents' economic choices alone or changes them, destroying neutrality. But even economic experts have a difficult time identifying and measuring how taxes affect economic behavior. For the voting public, it is only important that the features of the tax system should be plain enough for ready comprehension.

The partial overlap between transparency and neutrality, where tax expenditures are concerned, is misleading. There, the effect on behavior is deliberate and the packaging of incentives and penalties as tax rules is at best only slightly deceptive. Confusing transparency with neutrality may become more deceptive as these rules become part of the familiar landscape, but to that extent, the same rules probably also disturb neutrality less and less, given the adaption of economic agents across the full economy to what were initially isolated changes in economic choices.

As we have seen, however, tax neutrality does not promise or ensure tax transparency. This is conspicuously the case when the tax law allows taxpayers greater flexibility in choosing how their economic choices are classified for tax purposes. All countries allow businesses to be conducted using different legal vehicles, which are usually different juridical entities. Even this very general sort of flexibility obscures the tax treatment of the businesses to many ordinary taxpayers, who have no idea how the tax regimes applicable to these entities differ. In the United States, a conspicuous but narrower example is the electivity permitted to partners in allocating items of income, deduction, loss and credit among themselves (Utz 2002). The flexibility of these arrangements is directly proportional to their complexity, and their complexity makes them more obscure to non-specialists and even to business people who do not use the partnership in the ordinary course of their affairs.

In sum, fiscal transparency now has several meanings. The most often invoked is the transparency of an income tax system free of tax expenditures. It is true that tax expenditures look like adjustments that are needed for the proper measurement of taxable income, because they are formulated in similar language and take their place side by side with these inherently necessary tax rules. They are also easily identified, and many countries now make the listing of tax expenditures are normal feature of their budgets, ensuring a measure of transparency. For the taxpayer's everyday encounter with the tax law, however, official publication in a rarely read government document may be ineffectual.

The design of the income tax poses greater problems for transparency than that of other taxes. The income tax in practice, if not in theory, invariably distorts economic outcomes, for example, through the arbitrary element that every scheme for the tax depreciation of business assets must create. Income taxation of entities detracts from transparency in an even more systematic fashion because the tax incidence of these taxes is both theoretically and empirically so uncertain. While these two underlying problems link income taxation strongly with the types economic distortion just mentioned, remedying them has not been a political priority (Mirrlees 2010, p. 16-20).

On the other hand, public debate of tax expenditures at the moment, though reasonably robust, is strongly flavored with partisan political argument. When transparency is equated with tax neutrality, opponents of social programs argue that the very goals of the income tax require the abolition of tax expenditures. That equation, however, begs the question of transparency rather than analyzing it objectively. Critics of the social safety net do not usually mention the much more substantial tax expenditures, characteristic of every OECD country, that subsidize profit-seeking enterprises – accelerated depreciation, credits for various types of investment, deferral of shareholder taxation on undistributed corporate profits, exemption or lower taxation of investment gains. On the other hand, critics of these tax expenditures as uneven stimulative measures rarely criticize social subsidies improperly cast as tax measures.

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