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A Review of How America Was Tricked on Tax Policy: Secrets and Undisclosed Practices by Bret N. Bogenschneider

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BOOK REVIEW

HOW AMERICA WAS TRICKED ON TAX POLICY: SECRETS AND UNDISCLOSED PRACTICES BY BRET N. BOGENSCHNEIDER

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The book challenges conventional economic doctrine on taxes and tax policy; Bogenschneider proposes an alternative approach to tax policy premised on science and scientific evidence. Each of the five chapters covers a specific area of the policymaking process and suggests approaches for its improvement. Throughout the book, the reader is guided on the issues and content of the relevant chapters. It begins with a list of classic deceptions or "tricks" offered by economists that are widely used in policymaking in order to deceive the public on tax policy. This includes conventional misstatements that the wealthy pay significant amounts of tax, and that tax cuts for the wealthy and large corporations will cause economic growth, rather than tax cuts for small businesses.

The book is an eye-opener on how the interests of the extremely wealthy dominate the discussion and framework of tax policy discourse.[1] One striking deception of tax policy described in the book is the misconception that working people are less intelligent than the wealthy and, therefore, are prone to bad economic decisions. For example, the purchase of a sugar beverage instead of a much healthier non-sugar-sweetened beverage could be seen as a bad economic decision because the poor do not understand the negative impact of sugar on their health. As such, economists suggest that the poor should be taught to "correct" their behaviour and the way to do so is to heavily tax such "unhealthy" beverages. However, as Bogenschneider rightly points out, even if such products are taxed more heavily, they would still be cheaper than an expensive "bio" beverage or a bottled water. In fact, the sugar beverage even with the tax added might cost as much as $4 less, which is a material amount of money to the working poor, but not to the wealthy. As a result, the working

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1 As defined by one of the 2001 Nobel Prize laureates, Joseph E. Stiglitz, the wealthy are "the top 1 percent" of the world's population. See Joseph E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (Norton, 2012) 288. Stiglitz noted that '[t]he top 1 percent have the best houses, the best educations, the best doctors, and the best lifestyles, but there is one thing that money doesn't seem to have bought: an understanding that their fate is bound up with how the other 99 percent live'.

person, who cannot afford to be indifferent to prices, may be acting rationally in consuming a sugar beverage; in contrast, a wealthy person who can afford a more healthy alternative is the one who may be acting irrationally in consuming a sugar beverage – directly opposite to the conclusion of behavioural economics.

Bogenschneider explains that the reason for such problematic formation of tax policy is the lack of practical experience in taxation among economic advisors that, in turn, leads to the lack of information and empirical data on how the specific policy decisions may affect each and every one of us. As a result, tax policy decisions are being made based on mere guesstimates, which have, in many cases, dangerous outcomes. One prominent example is excessive taxation of low-wage workers who are already paying high taxes in order to compensate for the deficit resulting from cutting taxes for those who are paying very little tax or no tax at all.

In the *Introduction* section, Bogenschneider sets out an entirely different approach to our understanding of the tax system by relating the theory of taxation to the modern world. He argues that the current tax system is outdated and does not reflect any semblance of fairness and efficiency that tax scholars most often propose as the means to evaluate tax policy. Instead, he claims the tax system was designed by economists trained on the teachings of Thomas Malthus who fundamentally believed that the "labouring poor" (as Malthus called workers in his times of the Industrial Revolution two centuries ago) seem to live "from hand to mouth"; consequently, they rarely think of the future, so their heavy taxation can be justified because "all that is beyond their present necessities goes, generally speaking, to the ale-house."[2] Sadly, Malthus's ideas of not recognising any social cost of wage taxation are still alive and are applied today; they are manifested through high taxes on every worker's paycheque and virtually no taxes on those representing "the top 1 percent". Bogenschneider appears to be correct that Malthus does undermine some aspects of current economic theory.

The description of how misleadingly the tax system is presented to the general public by government officials, their economic advisors, as well as tax policy organisations, who are often influenced by political parties, is provided in the first chapter, *Tax Policy in the Oval Office*. Bogenschneider uses the well-known Laffer curve as an example of how wrongly tax policy can be formulated, when it relies on a merely theoretical economic model, and what potential negative effect it has on vulnerable social groups. The Laffer curve represents a U-shaped function that suggests that lowering tax rates might increase tax revenue. Since its introduction in the early 1980s, it has remained highly controversial and its implementation by previous U.S. administrations is believed to have resulted in significantly lower taxes on the wealthy leading to even more inequality. Given that economists develop models not connected to the real world, the only way to test such models is by applying scientific methods. One of the methods to test economic models is the practical experience of tax practitioners, which Bogenschneider calls "clinical" tax knowledge; this is similar to the familiar clinical knowledge of medical doctors "who, for example, see opioid abuse in the real world and then learn how it affects people."[3] A similar approach could be used in tax policy.

Bogenschneider argues for more explicit involvement of tax practitioners, including tax accountants and lawyers, members of what he refers to as the "professional tax guild", who regularly advise real businesses and real people on tax matters. They must have a seat at the table

2 Bret N. Bogenschneider, *How America was Tricked on Tax Policy: Secrets and Undisclosed Practices* (Anthem Press, 2020) 40.

3 Bogenschneider (n 3) 37.

and be part of discussions on tax policy, discounting presumptions that taxation is simple and that anyone without any tax training can advise on tax policy. He provides several illustrations of tax paradoxes, such as "wealthy people do not actually pay taxes", that are readily apparent to those practicing tax, but not apparent to those with no practical tax experience. This leads to the situation where economic theories remain untested as to whether they are right or wrong and their experimental application may have disastrous social implications.

In the second chapter of his book, *The Abandonment of Scientific Methods in Tax Research*, Bogenschneider elaborates on the role of science in formulating tax policy and shows how the application of scientific methods can drastically improve the policymaking process. The discussion is structured as a Q&A and begins with the following questions: "*What does it mean to "know"?* and, *"How does the current understanding of philosophy of science suggest that we humans "know" things?*"[4] Bogenschneider's answer to these questions is that what we "know" is based on evidence acquired through application of testable theories of cause and effect. The cause-and-effect economic theory could, for example, be formulated as follows: "A tax cut for wage earners will cause economic growth". Such hypotheses could then be refined over time to become more precise, so that one is able to say when and under which conditions this statement is true; but instead of testing hypotheses, economists today are building economic models with a number of variables. The problem with such an approach is that building a model of the real world with often unpredictable human behaviour is impractical; the real world has simply too many variables to consider.

Since the study of taxation is a category of social science and is premised on an understanding of human behaviour, Bogenschneider argues that those with "clinical" knowledge of taxpayers' behaviour and of tax law are ideally placed to formulate hypotheses about taxation. Instead of developing unrealistic models, economists should be able to test the close-to-real-life hypotheses developed by tax practitioners. This could change tax policy for the better but may not be easy to implement. It should come as no surprise that science and scientific methods are not always easily accepted, whether it is about taxation or other urgent issues. Similarly, such urgent issues as an excessive tax on wages and little or no tax on the wealthy are generally ignored by politicians and their economic advisors, despite the staggering rise in inequality and poverty.

The reader will learn about deceptions that have been promoted by politicians for decades in the third chapter of the book, *How the Business Tax System Favors Large Corporations over Small Businesses*. Here the author addresses the role of Congress in the tax policymaking process and claims that the tax system is not "neutral" and, contrary to widespread belief, does not favour small business. Quite opposite, the current tax laws are drafted in a way that allows large businesses to enjoy extremely low tax rates, whereas small business owners are subject to double taxation and high effective tax rates. For example, Bogenschneider provides evidence that the widely reported scare of "corporate inversions" of U.S. companies that were the main trigger of the tax cuts in 2017 was rather "a scare tactic and deception designed to mislead voters."[5]

The (un)fairness of high tax rates on productive work (which comprises over 80% of the overall revenue base in the United States) is addressed in the fourth chapter, *The Limits of Moral Philosophy in Formulating Tax Policy.* To find the answers to what is "just" and "right" when it comes to tax policy, Bogenschneider looks into moral philosophy, the philosophy policymakers most often apply to taxation (e.g., libertarianism, liberalism and economic theory). Despite the available evidence that higher tax rates are associated with higher rates of economic growth (taking as examples Japan or

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4 Bogenschneider (n 3) 50.

5 Bogenschneider (n 3) 71.

France), tax policymakers nevertheless believe that it is "just" and "right" to have lower tax rates on corporations. Instead of evidence or science, such belief is exclusively premised on moral philosophy.

In keeping with true Libertarian theory, according to Bogenschneider, "taxes on productive work should generally be disallowed as workers are entitled to hold at least some portion of the wealth derived from their work even if that means at times switching the rank-order of persons in wealth holdings not derived from productive work; absent an accounting method it's impossible to rank-order persons in wealth holdings anyway."[6] As such, Bogenschneider claims that the application of moral philosophy to taxation is inadequate as long as it fails to specify a means to count the results, or as he puts it, "to count the beans".[7] In the applied field of taxation, it is the method of accounting that should be a prerequisite to reach any moral conclusions about right and wrong.

To put this philosophical discussion into perspective, Bogenschneider provides an example of certain moral questions that become visible only through the method of accounting. Only by the process of "counting the beans" do the moral dimensions of tax policies emerge, such as the deferral of taxation of capital income but not labour income. In the modern tax system, labour income is always taxed immediately by cash withholding, whereas capital appreciation (whether stock or property) is generally taxed only upon a so-called "tax recognition event". For example, as a stock appreciates in value, the appreciation is not taxed until such stock is sold; if a person dies owning property, there is a "step up" in the asset's basis, where the basis is increased to the asset's fair market value at the date of the owner's death; thus, inheritors do not need to pay tax on the appreciation in the value of the capital asset. So, in the tax system as currently designed, a tax recognition event may be deferred indefinitely and appreciation in capital assets may never be taxed. The mere fact of the existence of tax deferral raises an important moral issue regarding the fairness of the tax system. For those who can defer taxation, the tax system would likely be considered fair, whereas for those who need to pay taxes currently in cash, the fairness of tax system would be questionable.

The conclusion of this and other examples provided by the author is that when politicians propose a tax policy that they claim is "just" or "fair", it depends on the method of accounting. If politicians apply a cash-basis method of accounting for one group of taxpayers and an accrual-basis method of accounting for another, such a claim is incorrect at best and, in Bogenschneider's words, is "a means to fool the innocent and take their money".[8] As a practical solution and best-case scenario for the application of moral philosophy in formulating tax policy, Bogenschneider suggests that fairness in taxation can be determined by politicians only in very general terms (where counting of beans is unnecessary). Once a tax policy proposal is approved, tax practitioners can step in to determine whether results are "just" in specific contexts by counting beans in the manner specified by the policymakers' selected moral framework, whether it is libertarianism, liberalism, or economic theory.

The implications of excessive taxation of wages are discussed in the last chapter of the book, *Wage Taxes Do Have Social Costs*. The negative impact and high social cost of wage taxation is exemplified by the key areas of tax policy that are relevant for every wealthy state, such as taking due care of public health, investing in education and wellbeing of children, and supporting small businesses for the overall benefit of society. By referring to the public health area of tax policy, Bogenschneider

6 Bogenschneider (n 3) 101.

7 Bogenschneider (n 3) 101.

8 Bogenschneider (n 3) 109.

deals with the issue of the inverse relation between the wage taxation and public health. He explains how the high tax rates on employment income leads to an increase in poverty rates among workers and, eventually, to their poor health and unemployment due to illnesses and disabilities. Thus, the high taxation of labour results in additional social costs, as it excludes a significant portion of employed individuals from the taxable workforce and reduces the amount of tax collection in the long run. In addition to the issues of public health, Bogenschneider also warns about the negative impact of high-wage taxes on such key areas of tax policy as investment in children and support of small businesses.

Bogenschneider's research might also offer valuable insight, though not specifically emphasised in the book, into the unfairness of the tax system from the perspective of gender inequality and the underprivileged status of women. Bogenschneider classifies U.S. persons into quintiles by income. The effective tax rate is very low for the top income earners, which conceivably is represented predominately by the male workforce. At the same time, income earners in each of the four lower-income quintiles pay roughly triple the effective tax rate of the highest-income quintile. Considering that women represent nearly 50% of the workforce and that, as evidenced by the official data, the majority of female employees are paid significantly lower salaries than their male colleagues, one may expect that such lower-income earners are primarily representatives of the female workforce. Based on Bogenschneider's analysis of the overall regressive nature of the U.S. tax system, the current tax system is especially harmful for women.

In the end, the claim of conventional economic theory that it is more efficient to tax labour than capital seems no longer to hold true. Bogenschneider provides sound arguments that "labor" should essentially be called "human capital" and be given the same tax treatment as that of classically understood "capital". The understanding of these issues is extremely relevant today, in an era of digitalisation and robotisation, where the new type of labour (non-human labour) is entering the workforce. Bogenschneider warns about the negative social implications of levying extremely high taxes on workers but providing special tax incentives for robots that would result in making human labour more expensive than robot workers. Governments are urged to focus on reducing the overall tax burden on labour.

To conclude, and as the key takeaway from Bogenschneider's book, policymakers are expected to not blindly follow the recommendations of economic advisors trained on outdated economic theories, such as Malthus's assault on human dignity. Instead, any policy advice should undergo a rigorous review by tax practitioners, and representatives of different backgrounds, training, and experience; such review should especially include low-wage workers who may be forced into difficult economic decisions related to food choices and health.[9] Finally, research on tax policy should be guided by science, not by baseless economic models that are formulated far away from real-life situations. In today's modern society, new tax policies should aim for more sustainable taxation that secures the wellbeing of all citizens and ensures that not only the "little people" pay taxes.[10]

9 Bogenschneider (n 3) 162.

10 Bogenschneider (n 3) 153. The quote "We don't pay taxes. Only the 'little people' pay taxes" is attributed to Leona Helmsley, who was convicted in a 1989 tax evasion trial. See *United States v Helmsley,* 733 F Supp 600 (SDNY, 1989).