BUSINESS LAW FORUM
TAXATION AND THE ENVIRONMENT

INTRODUCTION

by
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It is always a humbling experience for an elected policymaker to spend time amongst those who study and explain the law. Professor Lawrence Zelenak's presentation was eerily reminiscent of my experience taking a legislative drafting class at Lewis & Clark Law School in which I was assigned the task of interpreting a one sentence bill I had voted for in the Oregon State Legislature. Even though it passed unanimously, the measure was incomprehensible. I had the same disquiet and embarrassment as Professor Lawrence Zelenak used the "Hummer deduction" tax exemption for the heaviest, most expensive polluting luxury vehicles to explain why a carbon audit of the tax code was likely to prove irrelevant.[1]

As the sponsor of both the unsuccessful legislation to repeal the "Hummer loophole" and the successful legislation requiring a carbon audit, it was hard for me not to take Professor Zelenak's assessment at least somewhat personally. Yet these provisions, as well as the tax-related activity in Congress during the fall of 2010,[2] reveal both the problems and opportunities America faces in making our revenue system more fair, efficient, and ultimately, a tool to enhance the environment.

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[1] Lawrence Zelenak, *The Loophole that Would Not Die: A Case Study in the Difficulty of Greening the Internal Revenue Code*, 15 LEWIS & CLARK L. REV. 496 (2011).

[2] *See, e.g.*, Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504 (2010) (to be codified at 15 U.S.C. § 631).

Feigning surprise in discovering that politics impacts government processes is as contrived as Claude Rains telling Humphrey Bogart in *Casablanca* that he was "shocked, shocked" to know that there was gambling at Rick's nightclub.[3] It is rumored that you will even find politics in the offices of legal professionals, in the dynamics of law school faculties, and in the chambers of the Supreme Court. Politics are a fact of life—especially in government dealing with money in the appropriations process as well as tax expenditures. The challenge is to use our political system to solve problems rather than create new ones.

This Taxation and the Environment Forum comes at a good time. Now that we are a quarter century removed from two major tax and entitlement reforms, we have an opportunity to consider our prospects, along with spending, revenue and income tax adjustments. In the 1980s, Republican President Ronald Reagan and Congressional Democrats were able to avert a looming deficit in the Social Security program[4] with a significant increase in the payroll tax[5] and the first increase in the Social Security retirement age.[6] Three years later, President Reagan reached an agreement with a bipartisan group of leaders, including Ways and Means Chair Dan Rostenkowski and Senators Bob Packwood and Bill Bradley that reduced marginal tax rates, simplifying the tax code and broadening the tax base while eliminating some perverse incentives.[7] Unfortunately, the fundamentals of government programs other than Social Security were not altered. Everything from healthcare and social services to defense continued unabated while the fiscal situation was aggravated by a poor economy.[8]

The last half of the administration of George H. W. Bush and Bill Clinton's first two years brought dramatic reductions in spending coupled with tax increases.[9] These budget cuts and new revenues ushered in eight years of declining deficits, culminating in three consecutive years of budget surpluses.[10] In the first term of President George W. Bush,

[3] CASABLANCA (Warner Bros. 1942).

[4] Neil H. Buchanan, *Social Security and Government Deficits: When Should We Worry?*, 92 CORNELL L. REV. 257, 270–73 (2007).

[5] Social Security Amendments of 1983, Pub. L. No. 98-21, § 123, 97 Stat. 65, 87–88 (1983).

[6] *Id.* § 201(a).

[7] *See The 99th Congress: Its 1986 Record*, N.Y. TIMES, Oct. 19, 1986, at 31; David E. Rosenbaum, *A Tax Bill for the Textbooks*, N.Y. TIMES, Oct. 23, 1986, at D16.

[8] *See* Thomas O. Sargentich, *The Limits of the Parliamentary Critique of the Separation of Powers*, 34 WM. & MARY L. REV. 679, 713 (1993).

[9] TAX FOUNDATION, FEDERAL INDIVIDUAL INCOME TAX RATES HISTORY, 1913–2011 (2010), *available at* http://www.taxfoundation.org/files/fed_individual_rate_history-20101220.pdf.

[10] Stephen Dinan & Kara Rowland, *Obama Picks Lew as Budget Director*, WASH. TIMES, July 13, 2010, *available at* http://www.washingtontimes.com/news/2010

faced with the prospect of a $5.7 trillion projected budget surplus, the Republican-controlled Congress initiated the "Bush tax cuts" of 2001 and 2003.[11]

It is notable that even as taxes were being cut with the promise of economic prosperity and dramatic increases in spending, the eight years of the Bush administration produced the worst job-creation record of any administration since the Great Depression.[12] Of course, the bursting of the housing and financial bubbles,[13] along with the presence of a regulation-averse administration, contributed to that record.[14] While history will sort out the causes and culprits, the simple fact is that today (because of the economy and inherited tax policies) federal revenues as a percentage of GDP are lower than they have been in 60 years,[15] and will remain far too low to meet projected demands.[16]

We are essentially back where we started, arguably in a worse position, with a more complex tax system riddled with special interest provisions, 141 of which are temporary.[17] The challenge of Social Security looms larger because the adjustments of 1983 are being overwhelmed by the demographics of the Baby Boom retirements and the practice of using the trust fund surplus to mask the size of the federal deficit.[18] As the number of retirees explodes, the general fund will feel real pressure as the Social Security trust funds are repaid.[19]

/jul/13/obama-picks-lew-budget-director/print; Philip G. Joyce & Roy T. Meyers, *Budgeting During the Clinton Presidency*, 21 PUB. BUDGETING & FIN. 1, 5 (2001).

[11] John W. Lee, III, *Class Warfare 1988–2005 Over Top Individual Income Tax Rates: Teeter-Totter From Soak-The-Rich to Robin-Hood-In-Reverse*, 2 HAST. BUS. L.J. 47, 80–98 (2006).

[12] *See, e.g.*, Sudeep Ready, *Bush on Jobs: The Worst Track Record on Record*, WALL ST. J., Jan. 9, 2009, *available at* http://blogs.wsj.com/economics/2009/01/09/bush-on-jobs-the-worst-track-record-on-record/.

[13] Richard B. Freeman, *Reforming the United States' Economic Model After the Failure of Unfettered Financial Capitalism,* 85 CHI.-KENT L. REV. 685, 698–702 (2010).

[14] *See, e.g.*, David H. Getches, *The Legacy of the Bush II Administration in Natural Resources: A Work in Progress*, 32 ECOLOGY L. Q. 235, 235–40 (2005); Robin Kundis Craig, *The Bush Administration and the Environment: An Overview and Introduction*, 25 W. NEW ENG. L. REV. 1, 4–6 (2003).

[15] Getches, *supra* note 14; CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2010 TO 2020, at 75 (2010).

[16] *See generally* THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2010 TO 2020, *supra* note 15.

[17] John D. McKinnon & Laura Sanders, *'Temporary' Tax Code Puts U.S. in a Lasting Bind*, WALL ST. J., Dec. 14, 2010.

[18] Allan Sloan, *No Trust for Social Security*, FORTUNE FINANCE (Dec. 21, 2010, 5:00 AM), http://finance.fortune.cnn.com/2010/12/21/dont-trust-social-securitys-fund/; Mary Williams Walsh, *Social Security to See Payout Exceed Pay-In This Year*, N.Y. TIMES, Mar. 24, 2010, at A1.

[19] Robert J. Peroni, *Tax Reform Interrupted: The Chaotic State of Tax Policy in 2003*, 35 MCGEORGE L. REV. 277, 303 (2004).

The near collapse of the economy in 2008—as well as the prospect of prolonged economic difficulties and of even slower employment growth in the foreseeable future—have heightened the anxiety about the sustainability of existing fiscal models. The decision of the President and Congress in December, 2010—to essentially punt on the major tax and fiscal issues by simply extending most of the expiring tax provisions by borrowing another $858 billion[20]—will make everything harder and more contentious for the 2012 election and beyond.

Nevertheless, there is some modest reason for optimism. Despite the toxic political atmosphere, at some fundamental level, there is a public awareness of problems that will force businesses and government elites to reckon with these painful facts:

- The combination of the near economic collapse, falling revenues, and continuing government emergency measures have created multi-year trillion-dollar deficits.[21] This has become a major political issue, as it did during the Presidential campaign of Ross Perot nearly two decades ago.[22] The mismatch between unsustainable spending levels and declining revenues will force a reckoning—if not politically, then in the bond market. In the short term this has worked to our advantage. Thanks to even greater uncertainty in foreign economies, the flight of foreign investment to the dollar, among other factors, has driven our interest rates to historic lows. For four consecutive years, the January average total interest-bearing debt rates have been lower than those in each preceding year.[23] If these rates return to the historically modest levels of 2000,[24] almost half a trillion dollars more would be added to the deficit every year.[25]
- Program spending for Medicare, Medicaid, and defense (the three largest items in the general fund budget) has been increasing much

[20] *See* Editorial, *The Tax Cut Deal*, N.Y. TIMES, Dec. 19, 2010, at WK 7.

[21] *See* U.S. DEP'T OF THE TREAS., BUREAU OF THE PUB. DEBT, HISTORICAL DEBT OUTSTANDING—ANNUAL 2000–2010 (2010), http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_histo5.htm.

[22] Ted G. Jelen, *The Perot Campaigns in Theoretical Perspective, in* ROSS FOR BOSS: THE PEROT PHENOMENON AND BEYOND 1, 8 (Ted G. Jelen ed., 2001).

[23] U.S. DEP'T OF TREASURY, AVERAGE INTEREST RATES ON U.S. TREASURY SECURITIES, *available at* http://www.treasurydirect.gov/govt/rates/pd/avg/avg.htm.

[24] The average total interest-bearing debt rate for January 2000 was 6.537%. U.S. DEP'T OF TREASURY, AVERAGE HISTORICAL MONTHLY INTEREST RATES FOR 2001, *available at* http://treasurydirect.gov/govt/rates/pd/avg/2001/2001_01.htm.

[25] On January 31, 2011 the total debt held by the public stood at $14,131 billion. If interest rates were at levels last seen January 31, 2001—6.6%—then our interest payments would total $933 billion. But January 2011's interest rate was 3.0%, thus our debt cost less than half of what it would have in January 2001. Author's calculations from debt and interest information is published by the U.S. Dep't of Treasury, *available at* http://treasurydirect.gov/govt/reports/pd/mspd/mspd.htm (public debt outstanding) and http://treasurydirect.gov/govt/rates/pd/avg/avg.htm (average interest rates).

faster than the rate of inflation.[26] This is clearly unsustainable, especially when added to other spending areas like agricultural support and disaster relief funds. The pressure is clear and is rapidly coming to a breaking point.

- The tax code, a myriad of "tax expenditures," has grown so large that it now rivals total federal discretionary spending.[27] A modest limitation in the growth of these exemptions, deductions, and preferential rates would be one of the simplest and perhaps easiest ways to start bringing the deficits under control.
- Finally, the nature of the Bush tax cuts, along with the explosion of other temporary provisions, has changed the dynamic and altered the political calculus. Notwithstanding the December 2010 compromise struck by the President and Congress, the tax provisions expire in two years, providing potential leverage for the President. Should the President choose to take a stand and veto extensions that he believes to be imprudent, there is little doubt that his veto would be sustained.

When it comes to the environment, there are forces at work that may make change easier. The much-maligned SUV loophole, analyzed by Professor Zelenak, is very likely to be repealed. The provision and ridicule that it has engendered, coupled with the fact the Hummer Company is now defunct,[28] may finally enable the consignment of this egregious provision into the legislative dustbin.

There is also a larger dynamic at work as companies that require environmental subsides in the new green economy become ever-stronger competitors. Emerging technologies, such as wind, solar, and geothermal energy, present a more compelling case for subsidies than do fossil fuel subsidies, which have long since ceased to benefit the American consumer in either price or supply. These oil and gas provisions, some of which date to the original income tax statute,[29] are simply an added benefit for the companies involved. There is a possibility of uniting "green" business interests with environmental forces to reach an agreement.

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[26] RICHARD KOGAN, FEDERAL SPENDING, 2001 THROUGH 2008: DEFENSE IS A RAPIDLY GROWING SHARE OF THE BUDGET, WHILE DOMESTIC APPROPRIATIONS HAVE SHRUNK 1 (2008).

[27] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-690, GOVERNMENT PERFORMANCE AND ACCOUNTABILITY: TAX EXPENDITURES REPRESENT A SUBSTANTIAL FEDERAL COMMITMENT AND NEED TO BE REEXAMINED 35–36 (2005), *available at* http://www.gao.gov/new.items/d05690.pdf.

[28] Chris Isidore, *Hummer to Close After Collapse of Chinese Deal*, CNNMONEY.COM, Feb. 24, 2010, http://money.cnn.com/fdcp?1294792395536.

[29] *See* T.D. 2447, Treas. Dec. Int. Rev. 31, 31–32 (1917); GENERAL ACCOUNTING OFFICE, *Petroleum and Ethanol Fuels: Tax Incentives and Related GAO Work*, 8 (Sept. 25, 2000), *available at* http://www.gao.gov/archive/2000/rc00301r.pdf.

There are also circumstances that will compel adjustments. For example, environmentalists and economists have long argued for a transportation funding mechanism based on utilization, rather than on gallons of fuel consumed. To date, we have remained wedded to a federal gas tax[30]—virtually unchanged since 1993[31]—which is doomed as a long-term funding mechanism. Inflation, combined with a dramatic change in the composition of our fleets and the fuels they use, will force this day of reckoning. Over the last 20 years, the cost per mile for the American motorist using the roads has dropped by 50%. With the advent of higher fuel economy gasoline engines, hybrid cars, plug-in hybrids, electric cars, and hyper-efficient diesel trucks, the highway trust fund and fuel tax that support it are locked into a downward spiral. The link between gallons of gasoline consumed and road benefits has been shattered. The trust fund will not be able to keep with current needs, let alone future challenges.

If the program is to be sustained without a massive drain on the general fund, there will be no choice but to change. Transitioning to a vehicle-mile-traveled fee of a penny per mile would replace the gas tax. Two cents per mile would enable us to completely modernize our infrastructure, while helping reinvigorate the economy. The technology is already available for widespread application, having been tested in a very successful pilot project by Oregon's Department of Transportation.[32] Major trucking fleets already have the technology available to make this transition in a matter of months. This is just one example in which economic reality will force a change.

Since the fall of 2010, with the political firestorm over the national debt, there have been significant proposals for deficit reductions which include both reduced spending and tax increases, as well as reform.[33] These high profile, reasonably well-received efforts are starting to change the dynamic, making it easier to discuss items that previously would have been deemed politically impossible.

The overview of the environmental provisions of the tax code offered by the following outstanding symposium papers is a tour de force of the evolution of the tax code itself. The events in the months following fiscal and tax reports (notably the President's Deficit Commission[34]), along

[30] I.R.C. § 4081 (2006).

[31] Jonathan Williams, *Paying at the Pump: Gasoline Taxes in America* 5–10 (Tax Foundation, Background Paper No. 56, 2007), http://www.taxfoundation.org/files/bp56%20final.pdf.

[32] STATE OF OREGON, OFFICE OF INNOVATIVE PARTNERSHIPS AND ALTERNATIVE FUNDING, TRUCK ROAD USE ELECTRONICS PILOT PROJECT, http://www.oregon.gov/ODOT/HWY/OIPP/TRUE.shtml.

[33] *See, e.g.*, Deficit Reduction and Budget Reform Act of 2010, S. 3779, 111th Cong. (2010).

[34] NAT'L COMM'N ON FISCAL RESPONSIBILITY AND REFORM, THE MOMENT OF TRUTH: REPORT OF THE NATIONAL COMMISSION ON FISCAL RESPONSIBILITY AND REFORM (2010),

with the tax package and economic compromise ending the 111th Congress,[35] potentially set the stage for fundamental change.

Nothing is certain in today's political environment, but the convergence of economic realities, the discipline of the marketplace, and a growing array of interests with a stake in a successful transition suggests that, as bleak as the situation may appear and as chaotic as the tax system currently is, a path forward to reform is not just possible, but in some cases, probable.

available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

[35] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub L. No. 111-312 (2010).