A meeting of accountants and economists to talk about taxation sounds like the setup for any of a thousand or so jokes. Many of the punch lines of these jokes concern what a boring lot we are. The somewhat enlightened believe that accountants and economists aren’t boring people, but just get excited over boring things. Even within our respective academic disciplines, tax academics don’t get a lot of respect.

The truly enlightened, well represented among the membership of the National Tax Association and the readers of this journal, know that both stereotypes are untrue. I will not stoop to reply to the claim that we are boring people. That taxation is a boring topic is demonstrably rubbish. In reality, it appears boring only to those who are uninterested in human nature and the institutions that have been designed to channel human nature to build productive civilizations. Taxation is about the relationship between individuals and the state, about how a society overcomes the free-rider impulse that threatens to undermine beneficial collective action, and about honesty and trust. We academics who are compensated to ponder these issues, to uncover new insights about them, and to pass along what we know and have learned to others are lucky, indeed, and are laughing all the way to the classroom.

Of course taxation is not only about Rights and Justice. It is also about carry-forward basis, contingent interest bonds, generation-skipping transfer taxes, nonqualified stock options, and tax-free spin-offs, bringing to mind Napoleon’s quip that “from the sublime to the ridiculous there is but one step.” But a working understanding of both the details of the tax law as well as the economic and social framework within which the tax system operates is essential to evaluate tax policy. Having such a broad grasp of details and context plus the technical expertise to do serious social science research is difficult for any one discipline, much less any one person, and so it makes sense that interdisciplinary dialogue is critical for furthering our understanding of this critical aspect of government policy.

This special issue of the National Tax Journal contains papers presented at the 2002 Tax Symposium that met at the University of North Carolina. A similar symposium has been meeting, with one interruption, since 1990. The idea was simple enough: to regularly bring together academics from

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accounting and economics to present work—in-progress on taxation, and to ensure that at least one discussant of each paper came from the other discipline. The hope was that we would learn from each other—the authors from the discussants and the audience, and the audience from the author and the discussants. The hope was also that new professional relationships would be formed.

A bit of history. The 2002 conference was the fifth annual meeting at the University of North Carolina, but was also the twelfth meeting of the Tax Symposium, which began at the University of Michigan in April of 1990. The genesis for the initial conference was that the accounting group at the University of Michigan Business School had some extra funds, and wanted to strengthen its reputation in taxation. My arrival at Michigan three years earlier as professor and director of the newly-created Office of Tax Policy Research meant that there was some expertise in the study of taxation from the economics perspective. Some faculty got to talking, and the idea of a regular conference of accountants and economists focused on taxation was born. A call for papers was issued, and I, along with accounting professors and graduate students, set out to choose a program. The first conference was held in Ann Arbor on April 27, 1990, and met each year thereafter, sponsored by the KPMG Foundation. After the tragic death of the Michigan accounting professor Victor Bernard in November of 1995, the interest of the accounting group in co-sponsoring waned, and 1996 was the last year the conference was held in Ann Arbor. With a one-year hiatus, it was reborn at the University of North Carolina in 1998 and organized by the Meade H. Willis Professor of Taxation, Douglas Shackelford, a Michigan Ph.D. in accounting who had been an active participant since the beginning of the conference.

Anyone who has ever participated in an interdisciplinary academic venture will know that they often look better on paper (or on grant proposals) than they work out in practice. Differences in expertise and perspective can form a barrier to productive intellectual interchange. To be sure, some differences in the meaning of terms had to be cleared up. For example, at the first conference it quickly became clear that economists used the term “retained earnings” to mean earnings that the company still had, while accountants used the term in the strict GAAP sense of assets less liabilities less contributed capital. Ex ante I also worried that stereotypes would come in the way of reaching these goals—accountants knowing the details but missing the big picture, and economists living in a world of theory, unaware of how the world really works. Although there is no reliable data on under-the-breath mumblings over the course of the twelve conferences, I believe that this never emerged as a problem.

The start of the tax research conference coincided with the beginning of the extraordinary influence of the book by Myron Scholes and Mark Wolfson, first published in 1992 but widely circulated in manuscript by 1990. Shackelford and Shevlin (2001) assert that the SW paradigm “does not advance new theories or methodology,” but rather it adopts a positive approach to explaining the role of taxes in organizations. Its mantra (known as ‘all parties, all taxes, and all costs”) is that effective tax planning must consider the tax implications to all parties of transactions, the implicit as well as explicit taxes, and that the non-tax tax costs of a transaction must be considered. This discipline brought the tax accounting profession closer to the general equilibrium perspective that many economists naturally bring to analysis, and facilitated the cross-disciplinary dialogue considerably.
1990 was an auspicious time to begin for another reason. The ink on the landmark Tax Reform Act of 1986 was not yet dry, having been fully phased in only in 1988. It provided myriad natural experiments to study and learn about the impact of tax policy (maybe too many, because the very breadth of the Act made it somewhat difficult to examine the impact of one set of provisions, holding all others constant.) The Act coincided with the increasing availability of public–access versions of the individual tax return data used by the federal government, including a panel data set that followed thousands of taxpayers from 1979 until 1990, and the Compustat data concerning the financial reports of public corporations. There was much to study, and the wherewithal to learn much.

What follows is a personal intellectual reminiscence rather than a comprehensive retrospective survey of the Tax Symposium. Many exciting and influential papers have been presented over the years that don’t neatly fit into the issues on which I will focus. I hope, though, that my musings will cause readers to reflect on the enterprise that accountants and economists (and others!) who study taxation share. There has certainly been productive cross–fertilization across the disciplines. In this issue alone, there are two cross–disciplinary collaborations, one between an economist and accountants (Erickson, Goolsbee, and Maydew, this issue) and one between an economist and a lawyer (Gentry and Schizer, this issue). Although I cannot be sure that the Symposium was essential to these collaborations, these are among the most loyal of participants, and I suspect it mattered. One of the veteran attendees, George Plesko, was at the beginning of the Symposium in an economics department and is now in an accounting group.

What kind of cross–fertilization I expected has, though, changed over the years. At the beginning I thought the trade would be details for theory. The accountants would help us economists sort out the net effect of myriad complicated provisions, and alert us to which of myriad provisions actually binds. This turned out to be less of a distinction than I’d thought, as many economists (me excepted, I’m afraid) are quite willing to slog through the institutional details, and many accountants are well–versed, and indeed, extend the conceptual framework for tax analysis. Differences did emerge, though. Because of the origins of the discipline in business accounting, accountants tended to be more concerned with corporations, and less with purely individual tax issues. Maybe also because of the focus on corporations, the distribution of tax burdens and the equity—or lack of equity—of the distribution is less of a concern to accountants. They are more likely to investigate the impact of policy on the stock market, and less likely to venture into policy recommendations and critiques, for better or worse. I apologize for these gross generalizations.

Over the course of the Symposium I have viewed the potential symbiosis between accounting and economics through the lens of my current research interest. In 1990 I was preoccupied with the idea that all behavioral responses to taxation could be classified into three types: 1. real responses like saving, investment, and labor supply, 2. responses that reshuffle, re–label, or re–characterize the real activities of the taxpayer, and 3. timing responses that take advantage of changing tax rules or rates. I thought, and still think, that this taxonomy nicely clarifies the relationship between the traditional economics focus on real behavior and the tax accounting literature on the structuring and, well, accounting for, transactions and operations of corporations. These responses, I argued in Slemrod (1992), generally form a hierarchy with respect to the magnitude,
or elasticity, of behavioral response, with timing responses being the most elastic and real responses being the least elastic. For many purposes, what is important is the sum of all of these responses, captured in an elasticity of taxable income. Much of the pioneering empirical work about the elasticity of taxable income was presented and debated at the Symposium, most notably that of Auten and Carroll (1999).

By the mid–1990s I was preoccupied (okay, obsessed) with the idea of setting out a fairly general theory of the behavioral response to taxation that encompassed all three classes of behavioral response and sorted out the interaction among these responses (Slemrod, 2001). For example, in response to the estate tax why bother to reduce wealth accumulation if it can be avoided, or evaded? I presented a paper at one of the first Symposium meetings in North Carolina (Slemrod and Kopczuk, 2002) that argued that there is a critical difference between real behavioral responses and the second class. The first depend on largely immutable aspects of people’s preferences, but the second can often be intermediated by a host of policies. How much labor supply changes in response to the effective real wage rate depends mostly on individual preferences, but to what extent companies invert and re–incorporate in Bermuda depends on the rules and regulations that govern such behavior. In the latter case, there is an appropriate enforcement response that in effect determines the “optimal” elasticity of taxable income that trades off the costs of limiting behavioral response against the protection of the revenue base.

Now, writing in 2002, after Enron and WorldCom, I’m struck again by the fundamental symmetry between central accounting questions and fundamental economics concerns. A publicly held corporation must report to its shareholders and potential shareholders about its operations, from which these interested parties, including professional analysts, draw inferences about the company’s present and future profitability. But accounting is not an exact science (there’s one symmetry with economics!). Moreover, people are not pathologically honest and people in different companies are willing to push the boundaries of this inexactness more than others, either to give the impression of continual earnings growth, or else to outright mislead about the company’s situation, as both Enron and WorldCom allegedly did.

But this problem has nearly the same form as another one that has been treated in some depth by economists. Allingham and Sandmo (1972) portrays (individual) taxpayers as completely amoral, deciding whether and how much to evade taxes in the same way they would approach any risky decision or gamble, as an expected utility maximizing choice. Successful tax evasion increases income because it saves on taxes, but detected tax evasion results in a penalty. Optimal tax evasion, from the individual’s standpoint, depends on the chance of getting caught and penalized, what that penalty might be, and how risk–averse the individual is. Obedience, duty, and morality do not enter.

From this perspective, understanding accounting decisions requires getting a handle on the penalty for improper accounting and the chance that the penalty will be invoked. But there is an important difference between these two problems. Most economic analysis of tax evasion concerns individuals who are likely to be risk–averse, but a publicly–held corporation should act as if it is risk–neutral, because its shareholders can diversify. More importantly, decisions about accounting and taxes are not made by the shareholders directly but by their agents, whether that is the chief financial officer or the vice president for taxation. In order to align the incentives of the decision makers and the shareholders, the agents are likely to have
been granted stock options and may also have other ways their compensation is tied to observable outcomes. This setting suggests some fascinating questions. How does the contract between the principal and the agent change when there are penalties imposed by an exogenous authority, such as the IRS or SEC? From a normative point of view, what is the most appropriate cocktail of penalties to be imposed on the company and directly on the agents within the corporation, knowing that the contract may very well adjust to the enforcement regime?

Not only do the two reporting (to the shareholders and to the IRS) decisions have a similar structure, they also interact more directly. Under U.S. rules, if the rules are followed, some accounting decisions must be the same for both financial accounting and tax accounting purposes. In this case an accounting choice that reduces taxation must necessarily reduce the earnings reported to shareholders, and puffing up reported earnings has a tax cost. This tradeoff, and the value of reporting higher income revealed by choices along the tradeoff, have been extensively studied by accountants, often in the context of last–in, first–out (LIFO) versus first–in, first–out (FIFO) accounting. A classic example of the investigating the tradeoffs that banks make among book income, taxable income, and regulatory capital (Beatty, Chamberlain, and Magliolo, 1995) was presented at an early Tax Symposium.

The theoretical question about what to report, either to the shareholders or to the tax authorities, has important implications for empirical analysis. Much of the data we use to study the effects of taxation come from either the financial statements or the tax returns. For individuals, it is now well understood that the estimated response of reported decisions reflects a combination of how taxes affect real decisions and how taxpayers report on those decisions. This is why the positive analysis of how taxes affect behavior differs from the analysis of how prices affect behavior—there are possible responses to the tax component of a price that do not apply to the non–tax part of price. For example, an increase in a state’s cigarette excise tax will induce more smuggling while an increase in the wholesale, non–tax, part of the price will not, so distinguishing the tax from the non–tax component of price is essential for a complete analysis of the impact of changes in the retail price of cigarettes.

Empirical analysis of how corporations respond to the tax system that is based on financial reports is hampered by a double whammy. First, the financial reports may be massaged to mislead the shareholders. Second, and more prosaic, is the fact that corporations do not in their financial reports have to reveal exactly what tax they pay to the IRS, much less what their “true” taxable income is. One theme of the Tax Symposium has been to gauge what of a company’s true tax situation is revealed by financial reports, and the interchange between George Plesko (forthcoming) and, for example, Terry Shevlin (1999), has gone a long way to clarify the key issues.

At the core of all of these issues is information asymmetry. It is at the core of optimal tax design. If the IRS could costlessly observe everything about taxpayers, the tax system would be administered effortlessly. Moreover, taxes could be collected with no excess burden because tax liability could be based on an inalterable correlate of ability to pay, call it ability. It is because ability cannot be measured well that governments are left to consider taxing on the basis of alterable correlates with ability such as income, consumption, or wealth. Once the tax system is based on these alterable quantities, taxpayers proceed to alter their behavior in order to reduce their tax liability. We study just how they alter their behavior in order to assess whether tax policies have unintended consequences and also to assess how costly are alternative ways to raise revenue.
There is, of course, also information asymmetry between the insiders of public corporations on the one hand and actual and potential shareholders on the other. Integrating the information and enforcement issues that arise in the interaction of a taxpayer and the IRS with those that arise among the constituent principal and agents that comprise the taxpayer is a challenging and important item for the future research agenda. After all, the IRS is scrambling to do reliable matches between financial reports and tax returns with the hope that this will help shed light on tax evasion, while at the same time the information content of the financial reports themselves is being called into question.

We researchers can observe some of the information flows. We have extensive data on sanitized samples of individual tax returns. We have, or did have, from the Taxpayer Compliance Measurement Program, some information about the judgment of an IRS auditor regarding the accuracy of the taxpayer report to the IRS. We have good data from financial reports. Both are snapshots of what the taxpayer wants some audience—either the IRS or the investing public—to see, and are not necessarily accurate portrayals of the real, underlying activities or the financial status of the taxpayer. We may be misled if we ignore this and assume the reports to be the unvarnished truth.

My dissertation advisor Martin Feldstein often told his graduate students that social science research was like the parable of the blind men and the elephant. In the parable, six blind men “to learning much inclined” went to see the elephant “that each might by observation satisfy his mind.” Each of the six approached the elephant from a different angle and, depending on what part of the elephant that approach encountered, proposed a different version of what an elephant most resembled. The blind man who fell against its side theorized an elephant was like a wall, the man who felt the tusk hypothesized a spear, and the man who grasped the trunk proclaimed it was like a snake. The blind man who felt about the knee was clear that an elephant was like a tree, the man who touched the ear thought the wondrous beast was like a fan and, finally, the man who groped the tail was sure the elephant was very like a rope. The last verse reads “And so these men of Indostan/Disputed loud and long,/Each in his own opinion/Exceeding stiff and strong,/Though each was partly in the right,/They all were in the wrong!” Imagine how much more difficult the task of the blind men would be if the elephant had a reason to deliberately mislead them! Yet our task as researchers is not is not as difficult as the parable suggests, because we blind men and women who have been part of the Tax Symposium have been able to compare notes on what each of our approaches reveals, and from that to piece together what the wondrous beast of our tax system really is like.

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