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Stanley Surrey, the Code and the Regime

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STANLEY SURREY, THE CODE AND THE REGIME

by

*Reuven Avi-Yonah and Nir Fishbien**

ABSTRACT

Stanley Surrey (1910-1984) was arguably the most important tax scholar of his generation. Surrey was a rare combination of an academic (Berkeley and Harvard law schools, 1947-1961 and 1969-1981) and a government official (Tax Legislative Counsel, 1942-1947; Assistant Secretary for Tax Policy, 1961-1969). Today he is mostly remembered for inventing the concept of tax expenditures and the tax expenditure budget. This paper will argue that while Surrey was influential in shaping domestic tax policy for a generation and had an impact after his death on the Tax Reform Act of 1986, his longest lasting contributions were in shaping the international tax regime, since the concept of the single tax principle that shapes contemporary international tax reform efforts can be traced directly to his writing and activities both in academia and in the government.

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I. INTRODUCTION: WHO WAS STANLEY SURREY?

Many younger U.S. tax practitioners and academics may have never heard of Stanley S. Surrey. Older ones know that he was arguably the most important U.S. tax academic and one of the most important U.S. government tax officials of the twentieth century. But even people knowledgeable about Surrey mostly associate him with the tax expenditure budget, which is still a controversial subject.¹ This paper will

1. Tax expenditures are defined in the tax expenditure budget. Congressional Budget Act of 1974, Public Law 93-344, § 601, 88 Stat. 297, 323 (1974). For the most recent tax expenditure budget see U.S. DEP'T OF THE TREASURY, TAX EXPENDITURES (2022) (for Fiscal Year 2022). The concept was invented by Stanley Surrey in the 1960s. *See, e.g.*, STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES (1978). Law review articles by Surrey (and in some cases a co-author) on the tax expenditure budget include Paul R. McDaniel & Stanley S. Surrey, *Tax Expenditures: How to Identify Them; How to Control Them*, 15 TAX NOTES 595 (May 24, 1982); Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352 (1970); Stanley S. Surrey, *Government Assistance: The Choice Between Direct Programs and Tax Expenditures*, 8 TAX NOTES 507 (Apr. 30, 1979); Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970); Stanley S. Surrey, *Tax Subsidies as a Device for Implementing Government Policy*, 3 TAX ADVISER 196 (1972); Stanley S. Surrey & William F. Hellmuth, *The Tax Expenditure Budget—Response to Professor Bittker*, 22 NAT'L TAX J. 528 (1969); Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C. INDUS. & COM. L. REV. 679 (1976); Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Legislative Process*, in THE ECONOMICS OF TAXATION 123 (Henry J. Aaron & Michael J. Boskin eds., 1980); Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept: Current Developments and Emerging Issues*, 20 B.C. L. REV. 225 (1979). For the subsequent literature, *see also* Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155; Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165 (1993). In particular, *see* J. Clifton

argue that while Surrey was undoubtedly the creator of the concept of tax expenditures, his influence was more far-reaching than that. Surrey invented the ideal of tax reform as a base broadening, rate cutting measure which every subsequent effort to reform the tax Code up to and including the Tax Cuts and Jobs Act of 2017 (TCJA) is measured against.² And this was not even his longest lasting contribution to tax law. We will argue that Surrey's most lasting contribution was his articulation and implementation of the single tax principle in international taxation, which underlies both the current international efforts to curb base erosion and profit shifting (BEPS) and the international aspects of the TCJA.³ While the tax expenditure budget is controversial and may not have much of an impact in practice, and the ideal of tax reform as base broadening and rate cutting had its apogee in 1986, the single tax principle is only in the process of being fully implemented now, in the early 21st century, more than thirty-five years after Surrey's death.

Stanley Sterling Surrey was born to a Jewish family in New York City in 1910. He attended the City College of New York, from

Fleming & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437 (2008); J. Clifton Fleming & Robert J. Peroni, *Can Tax Expenditure Analysis Be Divorced from a Normative Tax Base?: A Critique of the "New Paradigm" and Its Denouement*, 30 VA. TAX REV. 135 (2010). The concept has also drawn significant criticism. See, e.g., STAFF OF JOINT COMM. ON TAX., 110th Cong., A RECONSIDERATION OF TAX EXPENDITURE ANALYSIS 29-33 (Comm. Print 2008); Bruce Bartlett, *The End of Tax Expenditures as We Know Them?*, 92 TAX NOTES 413, 414 (July 16, 2001); Boris I. Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244 (1969); Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661, 1662-63 (Mar. 30, 1992); Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX L. REV. 187, 201-02 (2004); David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 976 (2004).

2. See for example Andrew Chamberlain, *Twenty Years Later: The Tax Reform Act of 1986*, THE TAX FOUND. (October 23, 2006), <https://taxfoundation.org/twenty-years-later-tax-reform-act-1986/>; [<https://perma.cc/FCQ9-L9RB>] "Yesterday marked the 20th anniversary of the nation's most recent federal tax overhaul—the Tax Reform Act of 1986. Although much of what that reform accomplished has been unwound over the years by lawmakers eager to reward constituents with tax preferences, it stands as a rare example of bipartisan support for fundamentally sound tax policy."

3. Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle?: An Essay on the History of U.S. Treaty Policy*, 59 N.Y.L.S. L. REV. 309 (2015).

which he graduated magna cum laude in history at age 19 just as the Great Depression was about to begin, and then Columbia Law School.⁴ As he explains in his unpublished memoir, in law school he happened upon tax as a subject because he liked his Civil Procedure teacher, Professor Roswell Magill, “a dry, taciturn person who moved through the course in a most methodical fashion.”⁵ Magill complimented Surrey on an assignment, and this made Surrey take his elective class on taxation in his second year. As Surrey writes:

Somehow or other, I had come to like this astringent teacher . . . indeed to prefer him over some of the flashy types, such as Professor Llewellyn whom [sic] I often thought dramatically shouted complex nonsense to frighten or hypnotize the first-year Contracts class. Some other students had just the opposite opinion. One thing a law school teacher learns, often painfully, is that you cannot reach or appeal to every student in the class. Some students will consider you the best professor they had in school while others will see you as the embodiment of the evils of the tenure system.⁶

4. Why law school? Surrey explains: “The history concentration prompted me to register for graduate work at Columbia University. I also had, because my career choice was so uncertain, applied to and was granted admission by Harvard Law School. But the choice had been definite for the graduate history field. Then, during the summer, someone asked me just why did I want to be a history scholar and go on to teach history. I suddenly found myself without a convincing answer. So I decided, as a matter of default, to go to law school.” Stanley S. Surrey, *Fifty Years (A Half-Century) with the Internal Revenue Code*, unpublished MS, HLS library (SSS), I, fn. 1. By that time it was too late to matriculate at HLS, but not at Columbia. Surrey adds that “[a]lthough I did not know it at the time, the choice between the two schools was indeed a wise one. Columbia then was an exciting, vibrant school pursuing untraditional legal approaches and teaching, which did force those who met its challenge to think about the world rather than to accept matters just because they were around. The Law School in this respect was far ahead of Harvard, which was still following its long-structured traditional path.” SSS, I fn. 2.

5. SSS, I-1.

6. SSS, I-2-3.

After getting an A in Taxation (as Magill explained, “[Magill] did not use A plus”), there were no more tax classes to take (and most of the class Surrey took focused on state taxation). Surrey graduated in 1932 second in his class, and since jobs were hard to find, Magill hired him as a research assistant on a book he was writing on federal tax law with two economists, Robert Haig (of the Haig-Simons definition of income) and Carl Shoup (who would become important later in Surrey’s life). As Surrey explains, “[t]he project was the first of its kind since no one had yet attempted a coordinated structural analysis of the federal income tax that covered both theory and substantive rules.”⁷ This led Surrey at age 23 to an important insight, which he describes as follows:

With only my own reading and my own plan of internal organization to guide me, I surveyed almost the entire structure of the income tax. The background I thus gained was far more thorough than that obtained by many a skilled practitioner. While they did possess the day-to-day technical handling of the tax tools, I was forced to find the theoretical strands that held the structure together. As a result I had the rare opportunity early on to obtain a sense of that structure, as a whole, and to understand that the structure could be analyzed and dealt with in logical terms. A rational framework could be devised for the structure and in turn structural errors could be perceived. I saw the income tax not as a random body of rules and edicts but as an internally consistent framework. All of my later work has been dominated by that approach.⁸

This important statement shows that Surrey came up with the idea early on that the entire income tax had a logical structure, and hence that departures from that structure (“structural errors”) could also be identified. Moreover, that structure had nothing to do with the economic definition of income, since the Haig-Simons definition was only published in 1938 and Surrey’s vision was created in 1932-1933 (and there is no indication that he worked with Haig; as he describes it he worked alone with minimal guidance from Magill and his work was

7. SSS, I-6.

8. SSS, I-7.

incorporated into Magill's book *Taxable Income* (1936)). Thus the tax expenditure concept ("all of my later work") was based on a structural definition of the appropriate income tax base that was not identical to the Haig-Simons definition.

Surrey was also starting to publish his own research in taxation; his first law review article, co-authored with a law school classmate, appeared in the *Columbia Law Review* in 1932.⁹ His second article was based on one of his chapters for Magill and dealt with the assignment of income doctrine; it was published in the *Columbia Law Review* in 1933.¹⁰ This article was later influential in the developments that led to the adoption of the joint return in 1948.¹¹ Surrey was naturally pleased, since not too many law school graduates publish two law review articles in the first two years after graduation; but what he did not know was that the articles were read by a young tax lawyer in the Solicitor General's office, Erwin Griswold, and that they would lead him twenty years later to a professorship at Harvard Law School.

After a short and boring stint in private practice, Surrey joined the government as a labor lawyer in the National Recovery Administration and then the NLRB (1933-1937). He found the work important but "confining," and in 1937 accepted an offer to move to the Treasury General Counsel office (Magill was Under Secretary) to work on tax matters.

In his first stint at Treasury (1937-1947) Surrey was involved in numerous matters that had a long-lasting influence on the Internal Revenue Code ("Code"). For example, he initiated the practice of having Tax Court judges travel around the country to hear cases.¹² He invented private letter rulings by adapting closing agreements to future

9. Stanley S. Surrey & Jacob P. Aronson, *Inter Vivos Transfers and the Federal Estate Tax*, 32 COLUM. L. REV. 1332 (1932). This advocated applying the estate tax to inter vivos transfers, a position that is now reflected in the gift tax. It was the first of many of Surrey's articles that influenced the actual tax law: "Time proved we were on the right track and the article reads well even fifty years later." SSS, I-8.

10. Stanley S. Surrey, *Assignments of Income and Related Devices: Choice of the Taxable Person*, 33 COLUM. L. REV. 791 (1933).

11. "The discussion necessarily developed into the choice of the proper unit for income taxation and how a family should be treated under that tax. This article also still reads well fifty years later." SSS, I-10.

12. SSS, II-2.

transactions.¹³ He also pushed unsuccessfully for a single court of tax appeals.¹⁴

From 1938, Surrey was assistant Tax Legislative Counsel and then from 1942 Tax Legislative Counsel at Treasury, a position he held until 1947. It was here that Surrey developed his fondness for working with the economists in the Office of Tax Analysis, which at the time included such current and future luminaries as Carl Shoup, Walter Heller, Milton Friedman, Cary Brown, Richard Goode, Joseph Pechman and William Vickery.¹⁵ These were, at the time, mostly liberal-leaning economists:

Most of the Treasury economists of this period had liberal leaning fiscal views, a strong preference for a progressive income tax, and a strong regard for tax equity, for treating people with equal incomes equally in the tax laws. This stress on tax equity led naturally to a distaste for tax preferences, and “loopholes.” Moreover, conscientious work in the Treasury pushes a person very hard in the direction of tax equity, for one quickly perceives the responsibility that rests upon the Treasury to safeguard the fairness of the tax system.¹⁶

Alas, Surrey could not foresee that later generations of tax economists would reject the very notion of fairness as having anything to do with the design of tax systems, and especially object to the idea of horizontal equity (“treating people with equal incomes equally in the tax laws.”)¹⁷ This paragraph also suggests again that Surrey’s dislike for tax preferences had more to do with his idea of fairness than with an economic definition of income.

In Treasury, Surrey was involved in many provisions that are still part of the Code or remained part of the Code for decades,¹⁸ for

13. SSS, II-13.

14. SSS, II-20.

15. SSS, II-36.

16. SSS, II-37.

17. See LOUIS KAPLOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* (2002).

18. SSS, II 48-49.

example: the deduction for medical expenses;¹⁹ taxation of alimony to the payee and deduction of the payment by the payor;²⁰ a deduction for child care expenses,²¹ which barely got through the Ways and Means Committee “who believed mothers should stay at home”;²² a section allowing a deduction for expenses incurred in investment activities;²³ permission to a corporate group to file a consolidated return;²⁴ a carry-back of business losses;²⁵ and a rule limiting inclusion in income of recovered items previously deducted—such as bad debts or refunded tax—to situations in which the earlier deduction had produced a tax benefit.²⁶ “Nearly all the new provisions that did survive in the act, principally the relief provisions, remain in the Code today in much the basic way they were drafted in 1942.”²⁷ Surrey also invented “hobby losses”²⁸ and got the first limit on the acquisition of loss corporations enacted (section 269).²⁹ In 1944, as a result of the extension of the income tax to most of the U.S. population, Surrey was involved in the creation of tax tables and of the standard deduction, both measures designed to simplify tax administration for mass consumption.³⁰ In 1946 he was responsible for treating stock options as compensation not when they were granted (since “it was really impossible to measure [their] value with any reasonable degree of accuracy”) but when they were exercised,³¹ an approach that still applies today despite the advances in valuing options since then.³² He also created the concept of grantor trusts.³³

19. § 213(a). Unless otherwise stated, all statutory citations are to the Internal Revenue Code of 1986, as amended, and all regulations citations are to Treasury Regulations promulgated thereunder.

20. §§ 71(a) (inclusion of alimony in income), 215 (deduction for alimony paid) (both as in effect prior to TCJA).

21. Currently codified as a credit. § 21(a)(1).

22. SSS, II 48.

23. § 212(1).

24. § 1501.

25. § 172(b).

26. § 111(a).

27. SSS, II 50.

28. § 183.

29. SSS, II 59.

30. SSS, II 70.

31. SSS, II 84.

32. Reg. § 1.83-7(a) (third sentence).

33. SSS, II 87.

Finally, he invented the idea of the joint return with a “split income” approach (taking the combined income of the couple and dividing it into two, and then applying the resulting rate to the split income).³⁴ This was enacted into law in 1948 after Surrey left Treasury to go into law teaching.³⁵

One of Surrey’s main conclusions from his time in the government was a dislike of tax lobbyists and preferential provisions designed to achieve non-tax results:

Also, in this period the tax law was slowly but increasingly being used to meet social problems that were not tax oriented but instead lay outside a proper technical structure for an income tax. . . . Some of these departures were suggested by the Treasury and others by the tax bar. What we did not realize was that gradually there was being developed two strands of statutory tax law. One strand represented the constant shaping of a proper technical structure necessary to an income tax based on an accepted definition of “income.” The second strand involved using the income tax either to achieve desirable social goals, or to provide incentives for activities that the Treasury or [C]ongress decided should obtain government financial assistance through tax reduction. Gradually in subsequent years this second strand grew larger and today we find it responsible for the numerous and costly “tax expenditures” present in the tax system. But in that period and later the difference between the two strands and the problems thereby created were not perceived by the Treasury. Indeed, when relief for hardship was recommended, as for medical expenses, there was no clear realization that the deduction came at the top marginal rates and in this sense had an upside-down effect that would not be followed in any direct program of alleviation.³⁶

34. SSS, II 88-89.

35. § 51(b) (1948 Code).

36. SSS, II 95.

II. SURREY AS AN ACADEMIC

In 1947 Surrey decided to leave the government, since Congress was for the first time since 1932 controlled by Republicans, and accepted a teaching position at Berkeley Law School. He was recruited by Roger Traynor, whom he had worked with at Treasury in the 1930s. Given his numerous law review publications, he was immediately appointed to a full professorship. His principal teaching responsibility initially was taxation, which included in one class individual, corporate, estate and gift tax. In 1950, he published with Professor William Warren of Columbia the first edition of two casebooks on federal income and estate taxation.

These were the first casebooks to cover separately these two facets of the federal tax system. Also they were the first casebooks to emphasize both the statutory structure of the taxes, along with administrative material, and the policy decisions and struggles that lay behind the Tax Code and administrative action.³⁷

In 1949, Surrey began his work as the chief Reporter of the ALI income tax project, and also went on the mission to Japan with Carl Shoup that is still regarded as responsible for major features of Japan's income tax system, as well as credited with inventing the first VAT (although Surrey was not involved in the latter, since he was always against regressive consumption taxes).³⁸

In 1950, Dean Griswold of Harvard Law School offered Surrey a permanent position on the faculty, which Surrey at once accepted. As he explains,

While the California Law School was a fine place, Harvard was then—and still is—the pre-eminent law school. I had been flying east each month for the American Law Institute, and these monthly flights would continue, if I stayed in California. Also, I realized that Harvard was a better—and closer—base of operations for one interested in tax policy than was California. . . .

37. SSS, III 5.

38. See Keigo Fuchi, *Stanley Surrey and the Transformation of Administrative Law in Japan*, 15 U. PA. ASIAN L. REV. 172 (2020).

Harvard was, of course, a far different place to teach. Its graduates quite naturally could not perceive of any other institution as being worthy of the name law school. . . .³⁹

In addition to teaching the tax course from his two casebooks, at Harvard Surrey was able to resume his cooperation with tax economists:

As I became acquainted with these professors from other disciplines I decided to institute a Law School seminar on "Current Tax Policy" to be taught with an Economics professor and at times with a Business School professor. The purpose was two-fold: to give the students in the seminar a feeling for tax policy from both the legal and economic aspects and, far more important, to enable me to keep up with the current trends in economics and fiscal policy so that I could use this learning in my basic tax course. Not having an academic background in economics and not seeing the time to obtain that background, and more important to maintain it, this seminar device seemed, shall I say, the most economical approach. Ever since this start I continued the seminar, always with a Harvard economics professor. It was, I believe, the first interdisciplinary seminar in the Law School.⁴⁰

This innovative approach proved important when Surrey later returned to the government. Another important teaching innovation was a seminar on "current problems in taxation" taught with practitioners from the Boston tax bar, which kept Surrey current on what was happening in practice.⁴¹

Importantly, in this period Surrey developed his basic approach to tax reform, which he describes as follows:

39. SSS, III 10.

40. SSS, III-12. A particularly close connection was formed with Professor Richard Musgrave who later worked with Surrey in the government.

41. "The value to me was of great importance since I could bring to my basic tax course the current thinking in the frontier of the law firms." SSS, III 13.

Perhaps one of the important articles and also Congressional testimony in this period was a discussion of the contrast in our individual income tax between very high tax rates and the undercutting of the tax base through many tax preferences—“loopholes” in popular parlance—that made the actual effective rates of tax far lower than the high rate schedules would indicate, especially in the upper brackets. I suggested as a broad corrective approach the removal or lessening of the preferences and a reduction in top rates of tax.⁴²

Here was the theme that would dominate Surrey’s time in government and would eventually lead to the tax reform efforts of 1969, 1976 and 1986. To this day, this idea of rate cutting and base broadening is regarded as the hallmark of true tax reform in the United States.⁴³

Surrey also wrote a famous article on tax lobbying that would cause him trouble in his later confirmation hearings. The article shows his disdain for special tax provisions, even where they reflect the intent of Congress and are therefore not technically “loopholes.”⁴⁴ This article also foreshadowed his later work on tax expenditures.

Another important area for the first time was international taxation, where Surrey not surprisingly was against preferential treatment for foreign source income:

A principal area considered in the Congressional testimony covered, for example, the taxation of foreign income, where I argued against tax reduction for income from investment abroad, contrary to the efforts

42. SSS III 24, citing Stanley S. Surrey, *The Federal Income Tax Base for Individuals*, 58 COLUM. L. REV. 815 (1958), which developed from a statement before the House Ways and Means Committee. See Testimony (including “Statement of Stanley S. Surrey, Professor of Law, Harvard Law School”), in *Hearings on General Revenue Revision*, House Ways and Means Committee, 85th Cong., 2nd Sess., 2281-307 (1958).

43. See Chamberlain, *supra* note 2.

44. Stanley S. Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145 (1957).

of most businesses with foreign investment activities and also the Treasury Department.⁴⁵

On the eve of his return to the government, Surrey summarized his general view of taxation in the following terms:⁴⁶

An interest, greater than that of most lawyers or even of academics, in the basic structural aspects of the tax system, especially the income tax. This interest derived from my Treasury work, the ALI project, and my writing and teaching. The interest was based on the belief that the tax structure could possess a rational, integrated character and that a goal of tax policy was to work always in that direction.⁴⁷

But what was the normative underpinning of this desire to adhere to an overall structure? Surrey clarifies in the next paragraph:

A deep concern for tax equity and fairness, and hence a dislike of tax preferences and “loopholes.” This was coupled with a suspicion of the efficiency, let alone fairness, of tax incentives and tax subsidies, especially in the business area. The regard for tax structure and concern for equity naturally led to an interest in tax policy issues and decisions. They also led to an approach that sought to find the “right” answer to a policy issue in

45. See Testimony (including “Statement of Stanley S. Surrey, Professor of Law, Harvard Law School, Relating to the Taxation of Foreign Income,”) of Stanley Surrey Hearings on General Revenue Revision before the Committee on Ways and Means, 85th Cong., 2nd Sess. 1143-72 (1958).

46. This was included much later as part of Surrey’s memoir, but it was an attempt “as my academic career ended, to summarize both how I regarded my experience up to this point and how I thought others saw it.” SSS, III-33. It is interesting that this statement does not reflect that fact that Surrey returned to academia from 1969 to 1981, so that it may have been written earlier and inserted into the memoir.

47. SSS, III-34.

terms of structure and equity, and to the firm conviction that a “right” answer existed.⁴⁸

Here is the rationale behind both Surrey’s later fight for base broadening tax reform, which in turn led to the tax expenditure budget as a way of identifying “tax preferences and ‘loopholes,’” and his support for the extension of that approach to the international arena, which led to the single tax principle as a way of identifying international tax preferences and loopholes. Notably, the emphasis throughout is on fairness, although efficiency is also mentioned. Notably absent is any mention of the Haig-Simons definition of income as the base against which tax preferences or loopholes should be measured.⁴⁹

48. SSS, III-34-35. See also Surrey’s summary of the work of the Shoup mission to Japan: “No country is ever ready for an ideal tax system. But the blueprint for such a system must constantly be a part of tax policy. The blueprint is necessary to highlight departures from the ideal and to provide a force to measure the merits of the departures. Shoup was right in sticking to the ideal, rather than making the compromises he knew could occur in the customary battles over tax policies between equity and other goals.” SSS V-40.

49. In fact, Surrey explicitly rejected the Haig-Simons definition in his work on the ALI income tax project which contributed to the Internal Revenue Code of 1954: “We prepared a tentative outline of our task and then began with the easier parts of the Code. These were the definition of gross income and the enumeration of items included in income and those excluded. An interesting question at once arose—should we define “income.” Economists in various countries had wrestled for years and years, with disagreements and incompleteness. The economist’s definition accepted in the United States, that of Haig-Simons . . . covered too much ground—for example, imputed income would be included—and this would put astrain on the exclusive sections.” SSS, IV-15. So much for the assertion that tax expenditures must be measured against a Haig-Simons base and therefore not to include imputed income or unrealized income is incoherent, which was the basis for Professor Bittker’s critique of tax expenditures. In Surrey’s view, there is a concept of income, but it must be defined in pragmatic terms related to ability to pay, and therefore it was fine to exclude imputed and unrealized income. SSS, III-34-35.

III. SURREY IN GOVERNMENT: TAX EXPENDITURES, BASE BROADENING AND THE TAX REFORM ACT OF 1986

Surrey's return to the government began in July 1960, when he was asked to prepare a memorandum on tax policy for Sen. Kennedy's presidential campaign.⁵⁰ Surrey asked two public finance economists, Cary Brown of MIT and Richard Musgrave of Harvard, to join him, and together they prepared a blueprint for a rate cutting, base broadening tax reform along the lines of Surrey's previous efforts in academia and at the ALI.⁵¹ A major innovation they proposed was an investment tax credit (not a deduction, like accelerated depreciation or expensing) to spur business investment. Surrey summarizes the general conclusions of this paper as follows:

The paper then turned to a strongly urged recommendation for reform of the income tax through broadening the taxable base. This goal was to be achieved by eliminating or reducing many existing preferences that presently narrowed that base severely and thus made high statutory rates misleading. Items stressed, in addition to the previously mentioned [ones], included: withholding on dividends and interest payments to end the non-compliance in reporting this income; reduction in percentage depletion for oil and other material resources; a cut-back in various personal deductions such as for state and local taxes and mortgage interest; and restrictions on expense accounts.⁵²

50. SSS VI-1.

51. "[F]or individuals the paper stressed the importance of measures that would lead individuals to utilize their savings for productive investment. The program suggested was elimination of the exemption of interest on state and local bonds, with direct federal grants substituted, since the exemption was inefficient and drew individual funds away from business investment, and also elimination of the 4% dividend credit and \$50 dividend exclusion (1954 Republican innovations) as useless and inequitable incentives. The revenue so gained should be used to lower top income tax rates to 65% from the then 91%." SSS, VI-2. The capital gains preference was also slated for eventual elimination, a goal that was finally achieved (albeit temporarily) in the 1986 tax reform.

52. SSS VI-4.

After Kennedy's victory, Surrey and Musgrave participated in formulating tax policy proposals for 1961, including the rate reduction and the investment tax credit, paid for by some of the base broadeners mentioned above.⁵³ The report they prepared concluded:

It must be remembered that the case for reform rests on an unassailable base—the concept of tax equity under which persons with equal incomes pay equal taxes. The argument that with each taxpayer paying his share, in relation to other taxpayers with the same income, the rates of tax can be reduced and the same revenue still obtained is a highly effective argument. This aspect of associating reform of the tax base with rate reductions in the upper and lower brackets significantly differentiates this approach from the usual “loophole closing” campaign. What is needed is strong leadership to bring this argument forcibly to the attention of the public, backed by a program to accomplish the objective.⁵⁴

The result of this work was Surrey's nomination to a newly created position of Assistant Secretary of the Treasury for Tax Policy. Not surprisingly, there was significant opposition from those affected by the base broadening proposals, but Kennedy persisted and Surrey was confirmed. “From my position I regarded [the nomination] as a courageous step.”⁵⁵

Surrey's activities as Assistant Secretary from 1961 to 1969 were consistent with these efforts to achieve a base broadening, rate reducing tax reform. They led directly to the tax reform acts of 1969, 1976 and 1986, all of which bear the imprint of Surrey's vision. It is sad that he did not live to see the tax reform of 1986, which is still the ideal that all subsequent tax reform efforts including the TCJA are measured against. He would have thoroughly approved the many base broadeners it included, such as the elimination of the capital gains preference, the limits on tax shelters and the tightening of the corporate provisions

53. SSS VI-8.

54. SSS VI-15.

55. SSS VI-38.

(repeal of the “*General Utilities*” doctrine⁵⁶, imposition of limits on acquired losses). Unfortunately, this close to ideal state of affairs did not last, and by 1997 the differential between capital gains and ordinary income was back where it was before 1986. Other 1986 base broadeners, however, like sections 465, 469 and 382,⁵⁷ have remained in the Code.

Surrey’s main domestic contribution was the concept of tax expenditures, which he developed in speeches in 1967-1968 and in many articles and books after returning to academia. The concept and the resulting tax expenditure budget (1974) are still with us, but they are controversial and subject to constant academic criticism.⁵⁸ It should be noted, however, that most of this criticism is based on the idea that Surrey sought to measure tax expenditures against the Haig-Simons definition of income, and as we have seen, that is not true. As detailed above, Surrey had a more pragmatic concept of income based on ability to pay, and this is why attacking him for not treating the omission of imputed income or unrealized income as tax expenditures makes little sense.

IV. SURREY ABROAD: THE SINGLE TAX PRINCIPLE

Surrey had almost no exposure to international tax during his first decade in the government, which reflected the relative unimportance of the area in 1937-1947.⁵⁹ He thus was not a player in the formative period

56. Under the *General Utilities* doctrine, a corporation recognizes neither gain nor loss on its distribution of appreciated property to its shareholders. The doctrine can be traced to the Supreme Court case that bears its name, *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935).

57. These provisions restrict deductions for, respectively, certain activities not “at risk,” certain “passive activities” and net operating losses of acquired corporations.

58. See literature, *supra* note 1.

59. “International tax matters, both as to policy and legislative developments, played a minor role in the Treasury Department in the years I served in the Office of Tax Legislative Counsel.” SSS, V-1. One exception was section 903, which was designed to limit the foreign tax credit to income taxes and withholding taxes imposed “in lieu of” income taxes and exclude gross-based taxes, and is still with us. SSS, V-2. Surrey’s wish to prevent the income tax base from being reduced by credits for non-income taxes prefigures the later fight over tax sparing.

of the international tax regime, which was much more influenced by Thomas Adams.⁶⁰

Surrey's first important engagement with international taxation came during the ratification hearings for the U.S.-Pakistan tax treaty in 1957, when he was still an academic.⁶¹ The treaty included a novel provision that granted a foreign tax credit for taxes that Pakistan would have collected but for a tax holiday.⁶² Surrey testified before the Senate Foreign Relations Committee against ratification on the following grounds:

The foreign tax credit was designed to give a credit for foreign income taxes paid, and thereby to reduce the otherwise double taxation that would arise from application of both the United States and the foreign tax on the same income. But the Pakistan treaty would extend the foreign tax credit to a foreign tax not paid in a situation where no double taxation could exist. A U.S. corporation that could obtain a reduction of its U.S. tax on the foreign source income by showing a receipt for a foreign tax it had paid could now also obtain the credit by showing a receipt for a foreign tax not paid. As a result neither the foreign country, here Pakistan, because of its tax incentive reduction, nor the United States, because of the grant of a credit for a non-tax reducing pro tanto of the U.S. tax, would be taxing the income involved, and the corporation would be home free.⁶³

60. See Michael Graetz & Michael O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1027 (1997) ("If there was a founder of the U.S. system of international taxation, it was T.S. Adams.").

61. Surrey also founded the Harvard International Tax Program, which during its existence from 1952 to 2002 trained hundreds of senior foreign tax administrators, as well as launching the academic careers of many U.S. international tax scholars such as Oliver Oldman, Michael McIntyre, Alan Schenck, and Reuven Avi-Yonah.

62. Stanley S. Surrey, *The Pakistan Tax Treaty and "Tax Sparing,"* 11 NAT. TAX J. 156, 156-57 (1958); see also Stanley S. Surrey, *The United States Taxation of Foreign Income*, 1 J. L. & ECON. 72, 85 (1958). For the first broad statement of Surrey's opposition to preferential treatment of foreign source income see Stanley S. Surrey, *Current Issues in the Taxation of Corporate Foreign Investment*, 56 COLUM. L. REV. 815 (1956).

63. SSS V-68-69.

This is a clear statement of the single tax principle: international taxation should aim at preventing both double taxation and double non-taxation, and if the source country does not tax corporate income, the residence country should tax it instead to prevent double non-taxation (i.e., zero taxation). This principle would guide Surrey's work in the Treasury from 1961 to 1969.

The Senate rejected the Pakistan treaty.

Since then and up to the present the United States has refused to enter into tax sparing treaties with developing countries, although those countries have consistently requested such a provision in negotiations with the United States and the other developed countries have agreed to various . . . tax sparing clauses. Also, it became widely known throughout the international tax world, especially among developing countries, that Surrey was the evil genie preventing the United States from agreeing to tax sparing, and that belief persists today.⁶⁴

Surrey implemented the single tax principle in his work on treaties, since the treaties he negotiated with Luxembourg for the first time reflected the idea that there should be no withholding tax reduction by the U.S. unless the income was in fact taxed by the residence country. This idea was incorporated in the first U.S. model tax treaty from 1981, and has now resurfaced in the 2016 model as well as in the TCJA (e.g., the BEAT and the anti-hybrid provisions).

The most important application of the single tax principle in the 1960s was Subpart F. As we have previously shown, the origin of Subpart F was not capital export neutrality (CEN), or the idea that taxes should not affect the decision about whether to locate investment at home or abroad,⁶⁵ but rather the desire to prevent double non-taxation in

64. SSS V-80. In fact, after leaving the Treasury Surrey was heavily involved in helping developing countries on tax policy, including drafting the original UN model tax treaty (1980). For the current state of affairs see Reuven S. Avi-Yonah, *If Not Now, When? U.S. Tax Treaties with Latin America After TCJA*, 45 Int'l Tax J. 51 (2019).

65. PEGGY B. MUSGRAVE, UNITED STATES TAXATION OF FOREIGN INVESTMENT INCOME, 74-75 (1969).

situations where the source country does not tax. This is clear from the internal Treasury papers in the Surrey archive.⁶⁶ In our opinion, the reliance on CEN in drafting Secretary Dillon's message to Congress was not necessary (since the abolition of deferral could be defended on equity and anti-base erosion grounds) and was a mistake on Surrey's part (presumably inspired by his friendship with Richard Musgrave and familiarity with the work of Peggy Brewer Musgrave, who invented CEN and capital import neutrality in her PhD dissertation). Unfortunately, CEN became the main argument in favor of restricting deferral, and this opened the door for later economists to argue in favor of territoriality not in the name of competitiveness (since it was hard to argue in 1961, just as it is today, that U.S. multinationals are not competitive) but in the name of "capital ownership neutrality" (which is really competitiveness dressed up to sound more scientific).⁶⁷

The single tax principle is clearly the basis of current international tax reform efforts such as the OECD BEPS project, as well as the international provisions of the TCJA (which although it pays lip service to territoriality, in practice is closer to abolishing deferral with a minimum tax rate, a result Surrey would have thoroughly approved of). Thus, the spirit of Stanley Surrey still hovers over tax reform, at least in the international arena.

V. CONCLUSION: A PAGE OF HISTORY AND A VOLUME OF LOGIC

We have tried to show that the work of Stanley Surrey is still relevant. Domestically, it inspires us to strive for the ideal of tax reform as base broadening combined with rate cutting, which was achieved in part by the TCJA (albeit not in its treatment of pass-throughs or in its overall revenue losses). Internationally, it is the basis for BEPS as well as TCJA.

Surrey will always be associated with tax expenditures, but this was only a small part of his work, and it was emphatically not driven by a desire to measure everything against Haig-Simons. Instead, tax expenditures were part of a general effort to make the tax law more

66. See Nir Fishbien, *From Switzerland with Love: Surrey's Papers and the Original Intent(s) of Subpart-F*, 38 VA. TAX REV. 1 (2018).

67. Reuven S. Avi-Yonah, *Do Lawyers Need Economists?*, J. ACCOUNTING, ECON. & LAW: A CONVIVIVUM (Sept. 4, 2020), <https://doi.org/10.1515/ael-2020-0018> (reviewing KATJA LANGENBUCHER, ECONOMIC TRANSPLANTS: ON LAWMAKING FOR CORPORATIONS AND CAPITAL MARKETS (2017)).

equitable by eliminating unjustified preferences, whether they resulted from lobbying or from tax planning. The tax expenditure budget should therefore be seen as an invitation to measure each tax expenditure against horizontal equity, not against some theoretical definition of income. If anything is clear from Surrey's memoir, it is that he was a very practical person, not much given to theoretical speculation of either the philosophical or the economic variety. It is this page of history that should be his legacy to all of us.