

Close Encounters of the Tax Myth Kind

By David Cay Johnston

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In this column, Johnston addresses several tax myths, including the economic effects of the Bush tax cuts, the number of jobs created by targeted tax benefits, and how Formula One racing will help the Texas economy.

Two men approached me in the hotel hallway at a Florida convention the other day, eager to talk tax policy. The difference in their approaches to the issues highlights a crucial aspect of our national tax policy debate. So, too, do a conversation that a former IRS auditor had the same day with a former boss and a series of e-mail exchanges I had with a British journalist who writes about Formula One economics.

The two men had just sat through an hourlong panel I moderated on whether tax incentives actually create jobs and how to measure the costs and benefits of economic development. The panel drew nearly a hundred journalists attending the annual conference of Investigative Reporters and Editors, the nonprofit training organization for which I serve as a board member and treasurer.

Like just about everyone else, the two men took copious notes about how to investigate, including where to find and how to analyze data, and games governments play to hide numbers and obscure projects that consume quantities of tax dollars but generate few, if any, jobs.

But the first of the two men, who would only give his first name and whose identification badge was turned over, was having none of it. He wanted me to know that I had no idea what I was talking about when it came to taxes and that I should get some facts.

The Bush tax cuts prompted a 20 percent surge in income tax revenues, he told me with the kind of certainty that Eric Hoffer described in *The True*

Believer six decades ago. Detail after detail poured forth that he said I would know if I just took time to consult the IRS Statistics of Income tables. Explaining that I work with those tables daily did not slow him down.

I suggested he read my March 28 column, available for free at Tax.com, showing how income tax revenues have plummeted since 2001, the first year of the Bush tax cuts. When I explained that 2010 individual income tax revenues per capita were 27 percent lower than in 2001, and a third lower per capita, he simply ignored this and continued on. (For the column, see *Tax Notes*, Mar. 28, 2011, p. 1615, *Doc 2011-5999*, or *2011 TNT 59-7*.)

As time passed and I patiently tried to insert hard facts, it became clear that this man's sources for his data were primarily the opinion pages of *The Wall Street Journal*, tidbits from Fox News, and talk radio. It was also clear that no fact would intrude on his fixed beliefs.

Contrast this with the second man, who stood by patiently and then introduced himself by name and position. This Ottawa correspondent for the Canadian Broadcasting Corp. asked smart questions about where to find Canadian data to establish whether the growing number of economic development projects up north were actually generating jobs and how to measure their impact. He wrote down names of economics professors and consultants, including the ideological perspectives of various sources.

As I walked away from this, my mind turned to the brilliant 1970 film *The Phantom Tollbooth* by animator Chuck Jones that I had just watched again before sending a copy off to a grandson. The Norton Juster novel on which the film is based tells of a boy lost in ennui who goes on a journey through the divided Kingdom of Wisdom where King Azaz rules the land of words and his estranged brother the Mathematician rules the land of numbers. The boy frees the princesses Rhyme and Reason to restore sanity, logic, and happiness to the kingdom after escaping the Doldrums, jumping onto the Island of Conclusions, and almost getting bogged down in useless make-work by the Terrible Trivium.

The first man knew lots of numbers, but all of them were wrong and lacked rhyme or reason. The second man, however, wanted wisdom or at least hard facts.

How can we get a tax system that serves us when so many people ignore empirical facts? How can we elect leaders who will recognize taxes as a necessity of civilization when so many voters fervently believe something as incredulous as the Boston Tea Party being a protest against high taxes or that Paul Revere rang bells on his midnight ride?

Now let's turn from the body politic to the IRS and the calloused attitudes that years of severe budget restraints are fostering internally. IRS workers call me now and then with awful stories of being worn down by a system that must churn out finished audits, leaving lots of tax dollars on the table. While these experiences are not universal, they seem to occur with distressing frequency.

A good example comes from Remy Welling, the auditor who blew the whistle on backdated stock options to me and *Tax Notes's* Warren Rojas seven years ago. Welling was fired and barely escaped prosecution for revealing taxpayer secrets for actions that I think make her a national hero to investors and taxpayers.

When Welling ran into one of her old bosses at a bookstore, he asked how she was doing and then told her in no uncertain terms that she was a fool for going public about the backdated stock options.

As Welling put it, he "started saying how stupid I was to have objected to the backdating. He said everybody knew that was how large cases were worked at the IRS — that audit decisions were political decisions that were made at the top and that everyone went along. He said that was just how big business and government operate all the time." And then, Welling said, her old boss told her, in the context of the Madoff Ponzi scheme that went undetected despite warnings, that "financial statements given to the SEC are filled with lies."

Other IRS managers I have spoken to over the years about Welling and other whistleblowers have made similar, although far less blunt, assessments.

One of the worst attitudes that can infect law enforcement is to be reactive and only do as you are told. Proactive policing, whether on the streets or in audits, means paying attention and taking action. For blue suits, it means finding a reason to question people whose behavior suggests they are up to no good. For tax auditors, it means looking beneath the surface and fearlessly following the trail of numbers wherever it leads, as Welling did.

Had Welling's bosses listened, the whole affair would have stayed inside the agency and at least one case would have resulted in action. That the IRS was made aware of backdating and did nothing remains scandalous. So is the lack of congressional inquiry into how the IRS knew about the backdated stock options and, except for Welling, looked the other way.

How are we going to raise sufficient money to finance our government if the cynical attitude that organizations can lie with impunity on their disclosure statements and tax returns pervades tax law enforcement? And why would anyone do what Welling did if the result is to be fired, threatened with having your CPA credentials pulled, and threatened with prosecution?

And what of the gullible broadcast reporters who take claims about tax incentives and subsidies at face value, fostering false impressions? Or who go only so far as to quote those who say the subsidies are a bad deal without evaluating the facts? Or who react to what the race proponents claim instead of just checking the facts themselves, letting the subsidy-seekers set the agenda.

Here I point to the Formula One racing subsidies starting next year in Texas. Bernard Ecclestone, the British billionaire who has monopoly control of grand prix racing licenses, wants \$25 million a year to allow a race in Austin — a cool quarter billion if the races continue for a decade.

You can get an idea of Ecclestone's riches, held mostly in tax havens, from the third home just acquired by his 22-year-old daughter Petra. She just bought the 57,000-square-foot home of the late television mogul Aaron Spelling, according to *The Wall Street Journal*. It was listed for \$150 million. Petra also owns a \$91 million London residence.

So Texas has oodles of money to pay as a fee for a car race, but is so broke it must fire thousands of school teachers? This is sound government policy?

The race sponsors, led by San Antonio billionaire Red McCombs, say this is a great deal for the taxpayers, who will put up that \$250 million as well as pay for roads, water, sewer mains, and other costs.

The basis of their claims is this: 97,500 out-of-Texas visitors will visit Austin on race weekend annually, spending \$220 per day each on average over three days on food and beverage plus lodging costs. I called that malarkey in my June 6 column and showed why the promised benefits cannot materialize — not that they are unlikely, but that they are impossible. (For the column, see *Tax Notes*, June 6, 2011, p. 1095, *Doc 2011-11758*, or *2011 TNT 108-11*.)

Christian Sylt, publisher of *Formula Money*, insisted in a series of e-mails that I am wrong and that Formula One will mean economic development for Austin. Others posted at Tax.com, Nieman Watchdog, and other sites asserting that the numbers of out-of-Texas visitors must mean the race will be a net benefit to taxpayers.

The problem is that Austin has just 6,000 convention-quality hotel rooms, about 3,600 of

which are occupied in the normal course of business. Even if all other business stopped and a couple occupied every hotel room, there's only enough room at the inns for 12,000 race fans. Where would the other 85,500 sleep? Austin cannot accommodate 97,500 out-of-Texas race fans, not even if many of them flew in on corporate jets, because the airport lacks the capacity to land thousands of extra planes for a day, much less park them. At eight people per corporate jet that would be 20,000 flight operations — no, closer to 40,000 because the planes would have to land, leave and return because of lack of plane parking space. Not going to happen, which means the touted economic benefits are not going to materialize.

Sylt insisted that there are more than enough hotel rooms "in Texas" to satisfy the demand on race weekend. True enough, but nobody rents a room in El Paso when the activity is in Austin. San Antonio, the nearest city, is 80 miles away, and even if all of its conventional-quality hotel rooms are filled, there would still be thousands of race fans with no place to sleep.

If just one person comes, it means economic development for Austin, Sylt wrote, arguing that my column was utterly wrong.

Collecting \$135 in sales taxes (assuming \$660 for food and drink and \$1,500 for three hotel nights) at

a cost of \$25 million is indeed economic development — for Ecclestone. For Texas taxpayers it is grand prix robbery. The public does not know this, however, because these simple facts have not made it into the pages of the *Austin American-Statesman* or into that city's leading broadcast programs.

Just as this column was going to press, the race organizers announced they would no longer seek a \$4 million annual subsidy from the City of Austin; the \$25 million from state taxpayers, however, would still be paid to Ecclestone. Local subsidies for road and infrastructure improvements, as well as race weekend police services would still be a burden on city residents. The decision not to ask for the \$40 million over the next decade shows how when citizens organize, and subsidy news gets reported before the handouts, it can safeguard taxpayer funds.

That a significant number of Americans are certain that tax cuts mean more tax revenue, that a significant number of IRS managers go along with sophisticated tax cheating, and that journalists perpetuate tax myths should trouble us all because without taxes there is no America.

Your thoughts? E-mail me at JohnstonsTake@tax.org.