



How Did the Tax Code Get so Complicated?

Investor's Business Daily
March 28, 2005
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One thing is certain about taxes: The multivolume federal income tax code of today did not grow from a tiny eight pages in 1913 solely in order to be big enough for the task of collecting more taxes from more people more often.

Only a small portion of the tax code is directly involved in raising the amount of tax revenues needed to pay the public costs of a civilized society. The largest and most complex parts serve the ideological and political purposes of members of Congress. As one of its staff reports says: "Congress decided to use the tax system to encourage certain . . . behavior."

In the early days of the income tax, Congress was first concerned with establishing its new power to tax income and then with deciding whose income it was going to tax. Predictably, it decided to tax only the income of the wealthy (in 1913 only 85,000 people and less than 1% of voters). With that quickly settled, for the next several decades federal tax policy was primarily concerned with how much higher Congress could push the tax rates on rich people and corporations without destroying the emerging industrial economy.

In 1924, the Democratic Party's platform summed it up by declaring that the "income tax was intended to be a tax on wealth."

But World War II democratized the income tax. Nearly everyone became a taxpayer. High tax rates were no longer reserved for rich people. And the income tax was on its way to becoming the middle class burden that spawned Phyllis McGinley's little ditty:

I'm a middle-bracket person
With a middle-bracket spouse
And we live together gaily
In a middle-bracket house.
We've a fair to middlin' family.
We take the middle view.
So we're manna sent from heaven
To Internal Revenue.

As soon as the income tax became nearly universal among voters, the real power in Congress' "power to tax" became the ability to discriminate among them.

And all successive Congresses have assiduously gerrymandered the tax code for the purpose of collecting the maximum amount of tax from the smallest number of voters.

First, they adopted highly progressive rate schedules designed to increase the tax burden on people who comprise less than half the voters.

To further skew the tax burden away from a voting majority, Congress enacted special tax reducing deductions or credits and specified the characteristics of those allowed to use them. Finally, in more recent years, the Congress has used various "black box" tests to identify a minority of voters who are required to pay extra heavy taxes under special sets of rules that apply only to them.

As a result, the tax code is now eight times bigger than in 1954 and immeasurably more complex.

Because of Congress' dedication to systematic inequality among taxpayers, filling out a tax return is for some like running an obstacle course where the slightest misstep leads to disaster. For others, it is an exciting treasure hunt that leads to rewards. Many people even get "refunds" of taxes they never paid.

Worse, the rules keep changing and, frequently, so do the winners and losers. In the past 20 years, Congress has amended the tax code more than 10,000 times, and the turmoil never stops. Since 1993, before the ink dries on one set of tax rules, the Congress has every 18 months enacted several hundred new ones. No wonder Alan Greenspan recently said "stability" should be a main goal of tax reform.

The tax code's most Orwellian complexity traces back to the Tax Reform Act of 1986.

At that point, Congress dropped all pretense of evenhandedness and expanded an entirely separate income tax - called the alternative minimum tax (AMT) - that applies solely to people identified as not paying "enough" tax.

The victims are required to fill out two tax returns, one under the regular tax and one under the alternative tax.

And if they fail a complex mathematical inquisition, they are required to pay a penalty amount of extra tax.

Bias In The Code

As matters have turned out, a large number of middle-class voters are hit hard by the little monster called AMT.

Therefore, Congress is busy further complicating the tax code in an attempt to redirect the AMT back toward its original victims.

In the spirit of '86, the Congress also customized the tax code with complex phase-out rules (originally called PEP and PEAS) that target taxpayers who have rising incomes. As their incomes increase above specified benchmark levels, a formula "phases out" their access to certain IRAs, the child credit and even such basics as personal exemptions and traditional, itemized deductions.

This exercise in rank discrimination also backfired, hitting large numbers of middle-income voters with backdoor tax increases.

As a result, the Congress is now phasing out phase-outs - but only selectively and only one step at a time, thereby temporarily making the tax code even more complex.

Since 1981, the Congress has "churned" the tax code with 18 major tax enactments - half of them net tax cuts and half net tax increases. But few of these enactments were straightforward, across-the-board tax increases or decreases.

Instead, nearly all contained a mixture of increases for some taxpayers and decreases for others.

For example, when measured over 10 years, the 1997 act cut taxes by \$296 billion, but it also contained \$108 billion of tax increases for certain disfavored taxpayers.

Can't Understand It

A classic case is the American Jobs Creation Act of 2004, which contained an evenly balanced \$136 billion of tax cuts for some and \$136 billion of tax increases for others. To make it worse, the "mix" of tax increases and decreases for particular groups of taxpayers often shifts from one year to the next, resulting in a constantly changing kaleidoscope of tax increases for some and tax decreases for others.

Every time Congress increases or decreases taxes, many hundreds of additional miscellaneous changes in the tax code are made in order to gain the number of votes needed to get the legislation out of committee or for final passage in the House and Senate.

There was a time in the not too distant past when one of these tailor-made amendments to the tax code was an easy way of rewarding a loyal constituent - but tinkering with the tax code is no longer a job for shade tree mechanics. Today most of the "riders" that successfully attach themselves to each major tax act have been in the works for several years, make intricate changes in the tax code, and are understood by only the handful of taxpayers who are affected by them.

The tax code is too complicated for taxpayers or the IRS to understand and apply.

It is also complicated beyond the point of being able to serve the political and ideological interests of Congress.

Even the members of the tax-writing committees find it difficult to hang more gargoyles onto this overcrowded structure.

Perhaps it is time for these and other architects of the tax code to take another approach. The nation would be well served if they redirected their creative talents toward replacing the present baroque tax code with a minimalist version that is built around the principles of equality and economic good sense.

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