Almost everyone agrees we could make the income-tax system simpler, friendlier and more economically sane. But we haven’t, and we probably won’t. Getting from here to there is just too exhausting politically. We’d first have to overcome the opposition of most senators and members of Congress who derive much power and pleasure from inventing and defending the tax code’s complexities: all the special breaks for favored voting blocs and fashionable public crusades. Then we’d have to defuse the hostility of all the threatened taxpayers, including (possibly) most homeowners. It’s a long shot.

Tax season reminds us of both the existing system’s absurdities and the logic that keeps it in place. President George W. Bush’s fleeting foray into “tax reform” is instructive. In January 2005, fresh from re-election, the president appointed a bipartisan panel to recommend a tax overhaul. He wanted a streamlined tax system to reduce compliance costs and promote faster economic growth. The case for change is strong, as the panel's final report in November showed. The present tax system

^ costs about $150 billion annually for taxpayers to comply, a figure roughly equal to all household spending on electricity ($121 billion in 2004);

^ is so complicated that about 60 percent of taxpayers rely on professionals to do their returns;

^ creates perpetual uncertainty, because Congress constantly tinkers with tax provisions (since 1986, there have been 15,000 changes).

The tax panel proposed two alternative plans, each with lower tax rates and fewer tax breaks. The top personal-income-tax rates would drop from today’s 35 percent to 33 percent under one plan and 30 percent under the other. Both proposals would limit the deductibility of homeowners’ mortgage-interest payments. Both plans would raise the same amount of money as today’s income tax and provide similar progressivity--that is, the distribution of the tax burden among different income classes.
In theory, the panel could have gone much further. Consider the following arithmetic. In 2005, Americans' personal income totaled about $10 trillion, reports economist Patrick Fleenor of the Tax Foundation. Federal personal-income taxes were about $900 billion, indicating an average tax rate of about 9 percent. If all personal income were taxed, today's rates of 10 percent to 35 percent would range from 4 percent to 17 percent, estimates Fleenor. But much income--the "tax base"--isn't taxed. It's officially exempted from taxes (example: employer payments for workers' health insurance). Or it's offset by various tax breaks (example: IRA contributions). The panel actually proposed only modest modifications of these tax preferences.

So what happened? Nothing. The report "got filed somewhere in a White House closet," says former Democratic senator John Breaux, the panel's vice chairman. Breaux blames Bush's retreat on the failure of his Social Security proposals. According to Breaux, the president asked himself, "Why should I go out and talk for tax reform like Social Security and get nothing out of it?" Fleenor thinks Bush worried that any threat to the mortgage interest-rate deduction might weaken a housing market already beset by fears of a "bubble." Given today's budget deficits, any "tax reform" plan would also increase calls for higher taxes--anathema to the White House.

The larger political obstacle is that people don't want to surrender the concrete tax breaks of a complex system for the abstract advantages of a simpler system. Those advantages are diffuse and deferred; they go mainly to the nation as a whole. Meanwhile, tax breaks are identifiable and immediate; they go mainly to individuals. Suppose the mortgage-interest deduction causes people to overinvest in extra-large homes, as it surely does. The country would be better off if--absent the tax subsidies--people diverted more money into other productive investments. That's a mighty subtle pitch for anyone to give up a tax break worth (say) $3,000 a year. Even if total taxes didn't rise under "reform," individuals couldn't be certain whether their individual taxes would increase or decrease. There would be many winners and losers. Similarly, politicians disdain simplicity because it deprives them of the chance to brag about tax breaks that fight global warming, pay for college tuition or encourage retirement saving, no matter how ineffective these are in practice.

The only exception to this logic is the Tax Reform Act of 1986. It reduced the top tax rate from 50 percent to 28 percent. Some major tax breaks were abolished. President Ronald Reagan and congressional Democrats joined together. Unfortunately, tax politics didn't permanently change. President Bill Clinton disavowed the theory of the 1986 law--broaden the tax base, lower tax rates--by raising the top rate to 39.6 percent in 1993. Republicans and Democrats have eagerly engineered new tax breaks. This is expedient and, in the short run, popular. But we should not delude ourselves. In the long run, it boomerangs. By making the tax system more confusing and less conducive to economic growth, it sows public cynicism and discontent.

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