

The tax-code mess

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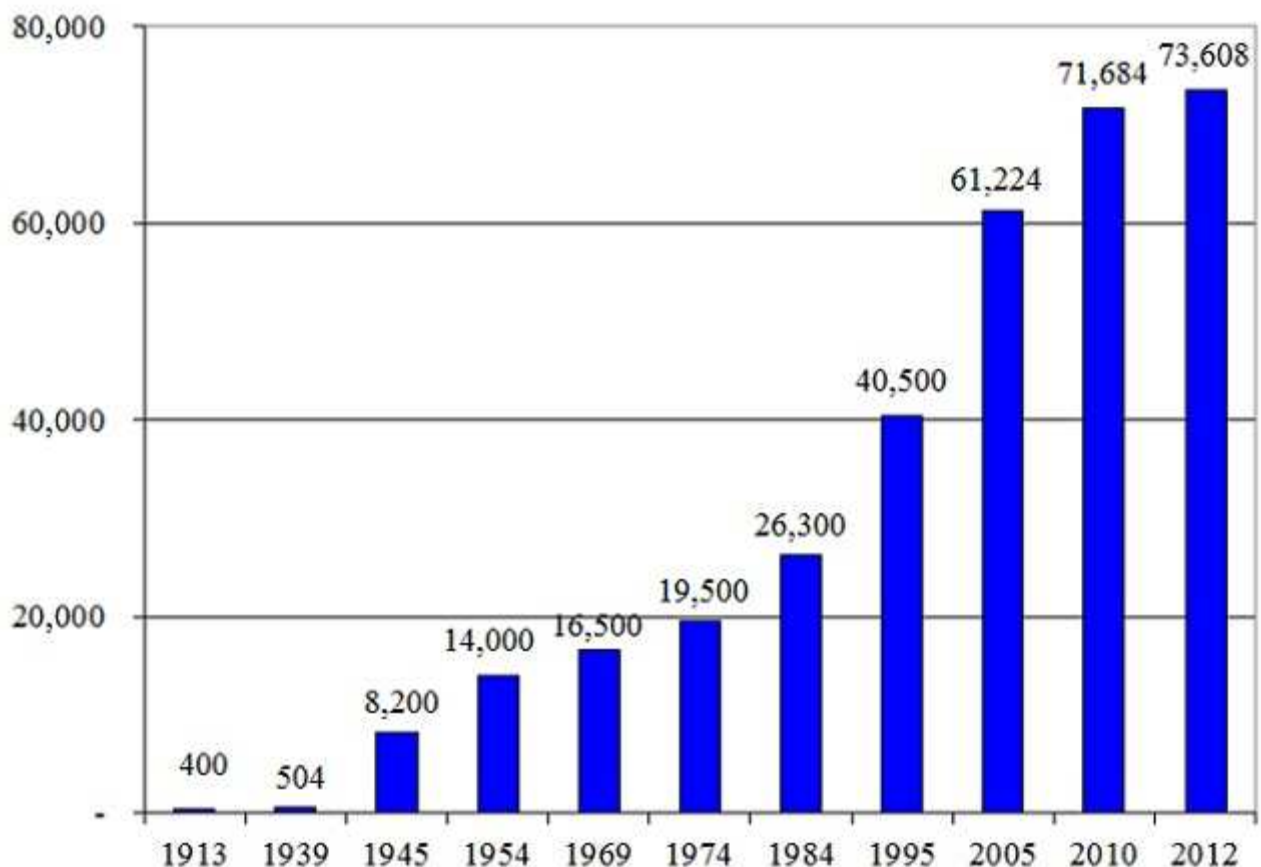
In recent weeks President Obama has been on a quixotic search-and-destroy mission for the few remaining millionaires who aren't already paying a huge pile of taxes. Meanwhile, the rest of us face the real-world struggles of filing our IRS returns and dealing with the hugely complex tax system that the president has done nothing to fix.

The federal tax code is getting uglier every year as politicians of both parties add more credits, deductions and other special breaks. In the first year of the income tax in 1913, the 1040 tax form came with just one page of instructions. This year the instruction book for the 1040 is 189 pages long.

That's just one IRS tax form, but there are more than 500 others. Consider, for example, that the number of special tax breaks for energy has soared from 11 in 1995 to 26 today, and each break has separate tax forms, instructions, regulations and other paperwork.

The total quantity of federal tax rules is gigantic. Tax publisher CCH collects all the paperwork in one volume, and it currently spans 73,608 pages and covers nine feet of shelf space. That is more than triple the volume of tax rules as recently as the 1970s, as shown in the chart.

Number of Pages of Federal Tax Rules



In a recent report, the IRS Taxpayer Advocate said that the compliance or paperwork costs for the federal tax code are more than \$160 billion a year. That cost represents pure waste to the economy — it's like throwing in the trash the entire retail sales of Target, Home Depot and Safeway every year.

In addition to being complex, the federal tax code is constantly changing. The Taxpayer Advocate found that there have been 4,428 changes to the tax code in just the last 10 years. Those changes stem not just from a hyperactive Congress, but also from the constant gushing forth of new tax regulations from the Treasury. The result is growing tax instability, which undermines financial planning, business investment and other decision-making in the economy.

All the different rates, deductions, credits and exemptions under the income tax create huge violations of the principle of equality under the law. For example, high earners typically pay a much higher share of their income in federal income taxes than do other Americans — despite President Obama's claims. IRS data show that households earning more than \$1 million annually pay about 25 percent of their income in federal income taxes, on average, which is more than double the average rate paid by middle-income households.

Even people with similar incomes are often treated unequally by the tax code because of all the special breaks for certain types of activities. The tax difference between a homeowner and renter with similar incomes, for example, could be thousands of dollars because of the special breaks for the former under the income tax.

The underlying cause of the tax-code mess is the political urge to socially engineer society. Many politicians are "class warriors," who favor penalizing high-income earners with complicated provisions such as the alternative minimum tax and Obama's new Buffett rule. Class warriors also favor subsidizing low-income tax filers, such as with the earned income tax credit, which is so complicated that it has an error rate of more than 20 percent.

Other politicians are "subsidy warriors," who push for special tax breaks to favored industries and favored types of families. They see the tax code as a tool to micromanage the economy — whether it is liberals pushing for solar power tax breaks or conservatives pushing for child tax breaks. We all end up being losers from this political activism because the resulting complex tax code wastes our time and reduces economic growth.

The good news is that some members of Congress are in favor of major reforms, such as scraping the current code in favor of a flat tax. The bad news is that tax reform has been blocked by other members who seem to have an insatiable urge to penalize some people and subsidize others. That damaging urge manifests itself on the spending side of the federal budget as well. In parallel with the rise of special tax breaks, the number of spending subsidy programs has soared from about 1,000 in the 1980s to more than 2,000 today.

Emblazoned on the Supreme Court building's façade is the promise of "Equal justice under law." Yet the horrendously complicated tax code illustrates how far the government has strayed from that promise. Sadly, the purpose of those 73,608 pages of federal tax rules is not equal treatment but the top-down manipulation of society by Washington.

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