THE ORANGE COUNTY REGISTER

Editorial: Income tax turns 100; good time to retire

February 5, 2013

A tax on consumption, with certain exemptions, would fund government while being less arbitrary.

When laws are arbitrary and indecipherable, public trust suffers. One hundred years ago, the 16th Amendment to the U.S. Constitution was ratified, creating the federal income tax. The law covered 400 pages, and the top tax rate was a petite 7 percent on earned income of more than $500,000.

As every income-tax-paying American is reminded this time of year, we have come a long way. The U.S. tax code today entails 73,608 pages, which, it is safe to assume, have never been read by the vast majority of people who must comply with the contents. A decade ago, one observer noted, the IRS tax enforcement army had grown larger than the U.S. Army in Iraq.

Income taxes, as the libertarian Cato Institute observes, are a bad idea that got worse. There is not even a consistent understanding in the tax code of what constitutes "income"; the law differentiates among bonds, dividends, savings, wages and capital gains.

The income tax distorts financial planning and business investment. It rewards tax avoidance and evasion. The tax's volatility results in constant changes, spawning an industry solely dedicated to tracking its ever-morphing regulations, and hundreds of discriminatory exemptions, credits and loopholes. Something is wrong when a law is measured by how well people avoid it.

The added perversion of progressively higher income tax rates compounds the income tax's punishment of wealth creation. Not only does the tax code punish hard work; the harder one works – the greater the punishment, and not just in dollars, but proportionately. During World War II, the top rate, which today is 39.6 percent, reached 94 percent on $200,000 income. Yet, attempts to gouge "the rich" result in productive people working less and retiring earlier, sapping economic vitality and destroying jobs.

"The fewer economic decisions that are made for tax reasons, the better," notes the nonprofit Tax Foundation's Center for Federal Tax Policy. But U.S. income tax laws are a study in how to waste time and money and misdirect resources.

Ideally, taxes should be collected to pay for necessary government activities. But taxes increasingly are used to micromanage the economy, bestow favors on select industries, individuals and products and as a cash cow for new political endeavors the government should not undertake in the first place.

Income tax volatility makes long-term planning difficult, resulting in shortfall crises and more unjust favoritism with tax holidays and amnesties. In short, the bloated tax code's web of deductions, credits and exclusions is a recipe for arbitrary governance and chaotic interference with economic activity. One low, broad-based tax rate could raise substantial, relatively stable revenue.

Washington is shamed by Russia, which in 2001 became the first major nation to institute a flat 13 percent tax. It spurred economic growth and boosted revenue. Russia's neighbors Estonia, Lithuania and Latvia followed suit and saw similar results.

More preferable, perhaps, would be to abolish taxes on income entirely, replacing them with a less-harmful tax on consumption, with exemptions for food and other necessities. But the temptation would be to impose a national sales tax in addition to the income tax. There probably would be less mischief in changing the income tax.

On this centennial of the U.S. income tax, we are reminded of the need for reforming our arbitrary, indecipherable tax code.