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The last days of the IRS

Confiscatory government leads to tax resistance

By Richard Rahn, senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.

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There has been much discussion about which banks and other financial institutions are "too big to fail." In reality, no institution is too big to fail, including any private company or political entity, whether it is Detroit or the former Soviet Union. The more relevant question is, which institutions are "too big to succeed"? When asked about President Obama's slew of recent troubles, former presidential adviser David Axelrod correctly noted that the U.S. government is too big to manage. It is not only true of the government as a whole, but also true of some of its parts, notably the Internal Revenue Service — which is in the processing of failing.

The IRS has an impossible job: manage and enforce the income tax plus a host of other activities, now including Obamacare. The problems begin with the fact that the tax code misdefines income. The IRS defines cash flow as income, but economists know that real income is the ability to consume. Cash flow resulting from inflation does not increase the ability to consume, yet the IRS often taxes it — and this is just one of many problems with the agency's income definitions.

The IRS taxes labor and capital multiple times, which creates enormous biases in the tax system favoring consumption over work, saving and its productive investment, and entrepreneurial risk-taking. Over time, such taxes eat away at productivity growth, resulting in lower economic growth, slow or negative job creation, and deteriorated living standards.

The high marginal income-tax rates that individuals and businesses face provide strong incentives for taxpayers to find both legal and illegal ways around the tax. To counter this erosion of the tax base, the IRS devises ever more invasive, costly and liberty-destroying rules. Also, members of Congress and the administration use the tax code to reward friends and punish enemies — by adding endless special-interest provisions — which in turn induce campaign contributions both from the grateful and the fearful. The result is an ever-growing tax code that no one understands — let alone fairly enforces. In 1913, the tax code consisted of 400 pages; by 1945 it had grown to 8,200 pages; by 1984, 26,300 pages; and today is estimated at more than 75,000 pages — despite periodic reforms. There is no politically doable tax reform shy of abolishing the income tax, which would reverse this process.

In a global economy, businesses and wealthy individuals can legally choose where to locate many of their activities. Localities that have high tax rates — Detroit and France being the poster children — drive businesses and the productive away. The United States, with the highest corporate tax rate in the world and increasingly destructive regulation, is driving multinational corporations and the jobs they create out of America. Political leaders who have been responsible for the lack of growth and job creation are now in the process of trying to build an international tax cartel in an attempt to keep the corporate and individual income-tax slaves on the welfare-state plantations. Ultimately, they will fail because if tax slaves are not allowed to flee, they will revolt.

The welfare-state politicians are using a two-pronged strategy to keep taxpayers in bondage. They are trying to create global tax-information sharing among governments, and global minimum income-tax rates. The just-concluded meeting of the Group of 20, using an Organization for Economic Cooperation and Development proposal as the cover, was the most explicit attempt yet to do the above. The United States has been trying to impose its Foreign Account Tax Compliance Act — which would force foreign financial institutions to report to the IRS — on other countries but, fortunately, has been meeting stiff resistance from responsible private parties and governments forcing a further delay in its implementation.

Those in government assure us that our tax information they intend to share with foreign governments will be kept confidential and not be abused. Only the terminally naive believe that. The IRS scandals will not go away because the measures needed to keep businesses and individuals on the tax plantation will become increasingly repressive, depressing economic growth and increasing resentment among taxpayers. It does not help that the IRS attracts as employees, for the obvious reasons, a disproportionate share of bullies, sadists, incompetents and those who have no understanding of the importance of the rule of law and liberty. Eventually, citizen anger grows to the point that the resistance against the tax-collection agency results in such a level of noncompliance that less and less revenue is collected, as we now see in Greece and elsewhere.

The income tax and the intrusive, abusive IRS are not necessary. The legitimate and proper functions of government can be financed through a combination of user fees and consumption taxes. The only real question is whether our political leaders will be wise enough to abolish the income tax and the IRS before the total breakdown, or after?