

How Pols Learned to Stop Worrying and Love the Impenetrable Tax Code

By [ANTONY DAVIES](#), [JAMES R. HARRIGAN](#)

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James Harrigan is a fellow of the Institute of Political Economy at Utah State University. Antony Davies is associate professor of economics at Duquesne University and an affiliated senior scholar at the Mercatus Center, where he authored [Tax Gimmicks](#) with Devin Bowen.

Politicians are in the business of buying votes with tax breaks and sweetheart deals for their preferred constituencies, and they have to offset these deals by taxing disfavored constituencies at increased rates. The longer this game is played, the more convoluted the tax code becomes. A cursory glance at the federal tax code bears this out. As of 2010, it was nearly 72,000 pages long. It would take the average worker more than 11 years to type the federal tax code.

Even the IRS, the agency in charge of interpreting and enforcing the tax code, cannot understand it. In 2008 the IRS answered taxpayer questions incorrectly 10 percent of the time, according to the Government Accountability Office.

None of this makes sense unless elected officials actually want this system. This is what economists call revealed preference. No matter what they say about the tax code during each election cycle, they can be judged by what they do about it once they take office. And after promising to simplify the code year after year, they instead make it longer and more complex at each opportunity. But why?

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The answer is simple: The more complex the tax code is, the more politicians can use budget gimmicks to hide the benefits they give to their cronies and traditional voting blocs as they position themselves for the next election. At the heart lies the politician's election-year mantra: I'll hand out more governmental largesse *and* lower your taxes. Only we can't have it all.

Politicians use tax gimmicks to maintain this fiction as they pick your pocket. Four types have long been very popular.

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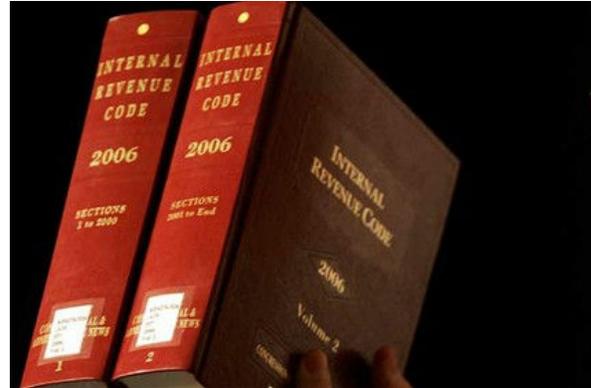
Temporary taxes are typically levied in response to some emergency—a natural disaster, or a financial crisis—and politicians promise they will disappear as soon as the emergency passes. But when emergencies pass, taxes remain. Consider the Johnstown Flood Tax, a temporary tax instituted to rebuild Johnstown, Pa. following the 1936 flood. It was never repealed, and has raised enough to pay for the flood devastation 25 times over.

Withholding is a particularly insidious tax gimmick because it causes workers to regard their wages as not their own. If workers had to write checks to the IRS every year for the full amount of their taxes instead of having them withheld, there would be a huge outcry about the cost of government. Withholdings also let politicians play the class warfare game, claiming that the middle-class pays more taxes than the rich. Voters buy the class warfare argument because withholdings obscure how much taxes people are actually paying.

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Another popular gimmick is to confuse deliberately who pays a tax with who delivers the tax to the IRS. Imagine that you are in line at a movie theater. You hand your child \$20 and tell him to buy two tickets. It would be ridiculous to claim that the child paid for them, but this is exactly what politicians claim when they talk about taxing corporations. Corporations only deliver tax money to the IRS. Taxes are paid by people. When politicians raise taxes on corporations, corporations respond by doing one of three things: they raise the prices of their products, they generate fewer dividends and capital gains for their stockholders, or they pay their workers and suppliers less. In the first case, the customers really paid the tax. In the second, the stockholders paid the tax. In the third, the workers and suppliers paid.

These three pale in comparison to the tax that is inflation. When the Federal Reserve increases the money supply—as it has attempted to do with repeated quantitative easings—inflation results. This causes everyone's money to lose value. When the Fed prints money to buy



government debt, it is as if the Fed reached into your bank accounts and retirement funds and handed your money over to the government. And it can do this without a Congressional vote, and without any elected official being held accountable.

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Stopping this spiral requires only two ingredients: a radically simplified tax code and a currency that is beyond the manipulation of the Federal Reserve. Attaining these ingredients is relatively simple. First, replace the entire tax code with a flat tax on income with a single deduction. No loopholes means no benefits for legislators to confer on cronies. Simplicity means that every future attempt to introduce new taxes or to raise existing taxes will be blindingly obvious to every voter. Second, our currency has to be pegged to something of independent worth. Gold is the obvious candidate. With the dollar's value fixed externally, the Federal Reserve could no longer inflate away the sins of government at the expense of the taxpayers.

There is little else that either party can do to help the economy short of these two simple things. And that's why the political class has spent more time lately talking about Big Bird than the Federal Reserve and the tax code.

- [Read James Rickards: Congress Must Simplify Tax Code](#)
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