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How the income tax expired: A View from 1994

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A View From 1994

How the Income Tax Expired

Is it good luck or good old American know-how that enables us to develop our technology just in time to solve the nation's economic, social, and political problems? The managers of U.S. fiscal policy in this year of 1994 are breathing a collective sigh of relief as computer technology and the miracles of miniaturization join to rescue the nation from the fiscal chaos of the mid-1980s. The irony is that the first dying gasps of the income tax system were heard as far back as 1982 but were ignored by the same pundits who today predict that technology will bring down the entire fiscal system.

The old income tax system operated effectively for many decades as part of an overall structure of income redistribution. While public moneys were used to provide housing for the poor, and to subsidize housing for the nearly poor, the tax system from which those dollars flowed also subsidized the well-to-do and even the wealthy. Tax deductions were allowed for interest payments on home mortgages and for local real estate and personal property taxes.

Similarly, while employers providing health care plans for employees obtained a deduction for those expenses, the employees were able to exclude any economic benefit they received from their taxable income. Each session of Congress seemed to provide some fine tuning here, some shift of emphasis there. But a symmetry of sorts was maintained—and practically everyone played the game by the rules, because each saw the rules as giving him or her an edge.

But overall it was not just a lack of symmetry which brought on the collapse of the income tax. Nor was it anything inherent in what was then referred to as "supply-side economics" (which has been characterized by one newspaper editorial writer as about as significant to economic theory as aluminum siding is to architecture).

No, the stress that collapsed the fiscal beast-of-burden's back turned out to be the fair-play doctrine espoused by the most stellar leaders of our society—the clergy, the college presidents, and the heads of charitable institutions and voluntary service organizations. Alarmed by the threat to charitable contributions that is inherent in reducing the tax rates of the rich, as well as by the lack of tax incentives for contributions from the increasing army of taxpayers who were using the zero-bracket deduction, these humanitarians succeeded in moving charitable contributions from being treated as itemized deductions, to being allowed whether or not the standard deduction was taken.

The "standard shift," as the new tax system was labelled (some wags called it the "standard shaft"), occurred at a time when the IRS found itself increasingly unable to audit more than a small percentage of individual income tax returns. The result was that by 1986 deductions for charitable contributions were claimed on 50 million individual taxpayer returns on which deductions were not itemized—with such deductions uniformly amounting to 50 percent of the reported adjusted gross income. Yet, there was little or no perceptible increase in actual charitable giving.

Attempts to restore integrity to the voluntary assessment process were repeatedly blocked by a lack of appropriated funds, an inability by the IRS to obtain and retain the highest-caliber audit personnel, and a vacillating concern by the congressional oversight committee about IRS abuses. The situation deteriorated rapidly from 1988 until 1990. When it became impossible to find any reputable attorney or CPA to assume the post of commissioner of Internal Revenue, and when many district director posts were being held by persons with fewer than five years of IRS experience, Congress finally was roused from its lethargy.

According to *The New York Daily Times*, the system was brought to its knees by the taxpayers' failure to report income, as well as by a gross overstatement of deductions. With reported income having shrunk to less than one-third of what it should have been, Congress had no choice but to act, since by then the annual deficit had passed $1 trillion for the first time in history and inflation had moved into triple digits, also for the first time.

But the electronic horseman was coming to the rescue. Most business already was being transacted by means of electronic transfer systems of one sort or another. A consortium of fiscal experts from law firms, CPA firms, and economic think tanks persuaded the Congress that some surrender of flexibility and equity might be a small price to pay for rescuing the economy from pending chaos.

Thus, the familiar universal transaction card was assigned to every person, based on Social Security and employer identification numbers. No transaction, not even the sale of a hot dog, was permitted without the card being processed. A flat tax of 10 percent was imposed on all transactions.

Deficit Eliminated/Inflation Reduced

Now, not even four years since the switch to TT (Transaction Tax), we can see amazing results. The deficit has been eliminated. Inflation is less than 3 percent. Very little time and energy is being expended with tax policy matters. We clearly have solved the problems of the old income tax, not to mention the side effects of overconsumption and inflation.

There are some disadvantages, of course. There is a suggestion of civil unrest in Keynesian quarters; others go so far as to claim that their civil rights are being infringed upon. The latter group was particularly incensed by the rumor that a thumb tatoo would be substituted for the familiar plastic ID card. Scientifically, of course, it is possible to imbed data beneath the skin which can be read by a laser scanner. Minority leaders of the Constitutional Party have offered that the thumb code might be preferable to today's flying squads of uniformed inspectors from the TTS (Transaction Tax Service) who converge on shopping centers in search of counterfeit cards.

But the inescapable fact is that close to one-quarter of all transactions are being handled outside of the double-T system. Compliance is an increasing problem. Thus far, the leaders of both parties state that only as a last resort will informants be rewarded. They recall the French government being nearly overturned when a dentist's son committed suicide after turning in his father for swapping dental services for carpentry work. Nor will one soon forget the televised Senate debates between the younger Kennedy senators and their uncle when Congress enacted the law penalizing transaction-tax violators—a lifetime increase in the miscreant's tax rate, with each offense calling for a 10-point increase.

But the unspoken possibility on everyone's mind in Washington is, of course, the proposal of the Hudson Institute. Never has the scientific community been so out of favor among the nation's power brokers. Off the record, everyone agrees that not only is the mouth monitor a universal solution to the compliance problem, it is also an answer to current concern about an overweight American population.

The proposal is simple. It calls for a miniature device to be implanted in a molar of everyone over age 11 in order to measure the caloric value of all the food and drink taken into the mouth. The device then would be read every three to six months. (A number of dental societies have already volunteered their members for this service; other offers have come from weight-reduction organizations.)

The number of calories consumed by each individual would be entered into the federal tax system by means of the tax transaction card; and the tax per calorie would be calculated by dividing the projected national deficit by the total caloric intake of all citizens during the year. Technology already exists, of course, to allow a uniform measurement of both fast chewers and slow chewers.

Perhaps the strongest objection to the proposal has been raised by the food industry. Theirs, however, is a short-sighted view, according to joint evidence prepared by the Department of Health and the Department of Agribusiness. With a massive reduction in weight, life expectancy would show a dramatic rise, say these administration statisticians. Thus, the calories being consumed by more people will balance the fact that the average person is consuming fewer calories.

For others, the proposal raises a more philosophical issue: the freedom to eat. They insist that it is a coercive measure that penalizes one for responding to his or her personal needs, especially the youth of the nation. It is expected that the administration's response to these and other arguments will be a major publicity campaign to stress the importance of personal health to the overall well-being of the nation.

The question thus facing Congress is whether or not this type of tax, which is not likely to be avoided and which will, in the aggregate, not discourage the activity from being taxed, should be adopted as the ultimate weapon against deficits. When compared to such alternatives as "fiscal restraint" and "defederalization of the economy," it is intensely attractive. Chairman Child of the House Ways and Means Committee, refusing to predict whether or not the proposal will pass, merely says, "It is now a matter of taste."

—*William Raby*