

## THE PROGRESS REPORT

### **The Ability to Extract**

By Fred E. Foldvary

Public-finance economists divide taxes into two types, one based on the ability to pay, and the other based on benefits received. The U.S. federal income tax is allegedly based on the ability to pay. That's why those with more income have higher tax brackets - they pay a higher percentage of their extra income in tax.

In practice, however, some high income does not get taxed. That's what tax shelters and loopholes are for. The government uses the income tax not just to get revenue but to favor certain groups and activities and to penalize others. The income tax is really based on the ability to extract, the ability of government to take income from those who don't have the political clout to get exemptions, deductions, credits, and special favorable treatment.

The tax changes recently passed by the federal government has added even more complications to the federal income tax. The bill has seven different capital gains tax rates. For example, collectibles are taxed at 28% rather than the 20% rate for stocks. Altogether the new tax law added 285 sections and amended 824 to the tax code, which totals 3,458 pages.

The little tax savings the public gets is offset by having to pay more to tax accountants and lawyers and tax newsletters, books, and software to figure it all out. We now have two types of IRAs. It's nice to have a new way to reduce taxes, but the whole concept of IRAs is an abomination, since if interest income were not taxed, we would not need two IRAs and the half-dozen other ways of sheltering retirement income, all with restrictions and complicated rules.

While the income tax code is becoming more complicated, audits of ordinary taxpayers are getting more frequent and handled less competently. According to testimony at a Senate hearing about the IRS, the audits assigned to junior auditors rather than experienced ones rose from 20 percent to 58 percent in the past ten years. The audit rate for the wealthy and for large corporations has dropped while audits of small businesses and those earning \$25,000 or less have doubled. The little guys are less able to contest IRS claims. On top of this, the IRS makes frequent mistakes due to its badly working computer system.

The basic problem here is giving the government the power to tax income in an arbitrary way. The political pressure is always to seek votes and campaign contributions with special tax treatments. So every few years, we get a new "tax reform" bill. The only effective remedy is a Constitutional change that bases public revenues on a rock-steady benefits principle. When you earn a wage, it's your labor, not the government's, so you should keep one hundred percent your earned income.

Most benefits provided by government services are territorial, from national defense to your local neighborhood park. These add value to land, and for the benefits received, the owners

should pay the market rent. And no exceptions: every landowner benefits, so all pay the market rent.

When rent pays the taxes, there is no record keeping and no tax audits. You don't need to hire a tax accountant. The government sends the landholder a bill, just like utilities do.

Attempts to have a flat tax or other simplifications of the income tax will all fail in the long run. The reason is simple: political pressure. The only solution is the the Constitutional one: eliminate the income tax completely, and replace it with a single tax on land rent that all landowners pay at the same rate. Do this, and our tax troubles will be gone in one generation.