

TAKING ON A TAX SYSTEM RUN AMOK

Spring is a beautiful time of year. New flowers and the prospect of long days fill our hearts with delight. Looking back, we see another winter has come and gone and we have survived, and hopefully thrived! Many of us feel a special sense of relief in that another tax season has passed and we can look forward to the next ten months where, if our determination is strong, we can ignore the revenue collection arm of the federal government.

Having reviewed many tax returns in detail over the last several months, I believe it is appropriate, now that we have the prospect of balmy weather and outdoor activities ahead, to take a long hard look at our country's tax program. It is important to face the unpleasant fact that our system has run amok. My intent, in this column and next two articles that follow in the coming months, is to provide readers with some substantive food for thought.

No one doubts that our tax system is incredibly dysfunctional. Even government bureaucrats and policy makers bemoan the complexity of the current system. In a letter brought to my attention, the IRS apologetically stated that even though the instructions for filling in a certain section of the tax return read one way, (and it took five pages of small, single print directions to guide the interested taxpayer through the maze), there was a small paragraph at the end of the letter stating that a small group of tax lawyers had determined that the actual effect of the now current tax law was the exact opposite of what they had just explained in the instructions.

The IRS offered an apology, a tacit admission that their own interpretation, based on common sense and the ability to read English, was wrong and they proceeded to shrug their shoulders at the complexity with which we as taxpayers must cope. It seemed to me that they were well aware of the implausibility that normal people can comply with the system and that it has gone beyond their control as well. There is, in fact, no one in control.

There are still a few brave souls who do their own tax returns. Those who use a computer program have to trust the program to know the intricate interaction of various rules, and these taxpayers are forced to blindly accept computer modeling of different solutions. Doing federal tax returns on one's own, without a computer program, if you have anything other than W2 reported wages, interest or dividends, is a daunting task. Ten years ago, I was able to read and follow instructions and work through the various IRS schedules, but this is no longer the case, especially where complex investment reports such as K1s are concerned.

There are regular calls in Congress for tax simplification. No politician is against it. Why has there been no action? One easy answer to this is the fact that special interest groups from all parts of the spectrum have ingratiated themselves and their pet ideas into

the tax code. Every few years, there is an act of Congress that is generally called tax "simplification" but all it does is add volumes of further detail to the code of law and rulings that one must puzzle through to know what the law means.

Who is served by this complexity? Even though our tax system serves as a full employment act for people in the accounting field, most accountants I know bemoan the fact that their jobs have become so overly complex as to be absurd. As a result, most Americans have moved further and further away from understanding how we got here and why must our government work in this way.

In 1861, the first U.S. federal income tax was put into place. It taxed income from \$800 to \$10,000 at the onerous rate of 3%. Amounts over \$10,000 were taxed at 5%. Eight hundred dollars per year of annual income in 1861 is roughly equivalent to \$25,000 today. There were no exemptions, no deductions, no depletion, no depreciation, and no charitable contributions. It was made simple so that citizens could understand what they were paying, and in fact, everyone paid their share though not very cheerfully.

These first taxes were put in place to pay for the Civil War, which was partially fought so that the United States could become a unified country and not just an amalgamation of individual states, loosely subscribing to a proclamation on paper of indivisible rights and liberties for all. Though there was scattered resistance, the general U.S. population did not object to the imposition of taxes for very long, and the government was able, in 1864, to raise the tax rate on incomes over \$10,000 from 5% to 10%! The U.S. also had to borrow money to fund the Civil War. People are generally willing to pay taxes (and buy low returning bonds) in times of wars and emergencies. Perhaps this is one reason why we are told that there is now and will be forever in the future a perpetual war (like on terrorism).

In the 1860's, there were also substantial consumption taxes. Most revenue came in the form of what we now call "sin" taxes. The tax on liquor was \$2.50 a gallon. This was roughly ten times the actual cost of the whiskey itself, so that a 25 cent bottle of spirits had an additional \$2.50 tacked onto it, yielding a total cost of \$2.75. All forms of transportation were taxed as was every form of advertising. Can you imagine what it would be like if every newspaper, radio, television, movie, and billboard installation was taxed to support the nation? We might climb our way out of debt and improve the quality of public life at the same time!

The social, economic, military and cultural issues facing our nation now are as vast as they were in the 1860's. Real simplification of the tax code, as I will describe in detail in next month's article, should be something we discuss with our friends and neighbors. Only by taking on the unpleasant monster of a tax system run amok can we reestablish a government that is "for the people and by the people" as the original framers of the Constitution envisioned.

Rob Rikoon is a Registered Investment Adviser. He can be reached at rriikoon@aol.com or 989-3581.