



## Why the IRS Cannot Be Reformed

by Richard W. Rahn

### IMPRECISE TAX LAWS LEAVE ROOM FOR AGENCY ABUSE AND CORRUPTION

Every few years, at least from the time of President Franklin D. Roosevelt, there is a scandal involving abuse of power at the Internal Revenue Service. We are again in the midst of one of these periodic abuse scandals, with many solemn promises that the problems will be corrected and will not happen again. As always, the rhetoric is far from the reality for two basic reasons. The first is the nature of the income tax, which, by definition, is subjective in its interpretation of the definition of "income" and thus subject to abuse. The second is the type of person that the IRS attracts as an employee.

A substantial (and ever-growing) portion of the income-tax code and IRS regulations are devoted to trying to define income. This may seem simple, but consider a business that operates in numerous states and countries and has many product lines. Beginning accounting students learn that business profit or income is equal to net revenue minus expenses. Yet, it is almost impossible to precisely define what is and is not a legitimate expense. What is the proper rate of depreciation for each and every item the business uses? How should a company allocate business revenue and expenses among many taxing jurisdictions? Different countries, states and localities often have conflicting standards, definitions and laws. The never-ending definitional problems provide full employment for tax lawyers and accountants, and they create a costly burden on businesses.

These costs are passed along in lower wages for workers and higher prices for consumers.

Economic income is defined differently than taxable income. As a result, most companies are required by law to keep a separate set of books to comply both with Securities and Exchange Commission regulations and IRS regulations — and often other sets of books to comply with the regulations of foreign countries.

The IRS is inconsistent, even with individuals, in definitions of income. In some cases, adjustments are made for inflation, but not in other cases. For instance, with capital gains and interest, the IRS charges tax on the purely inflation portion, which is not income by any reasonable economic or common understanding of the word. In so doing, the agency is corrupt in the Orwellian sense. When the federal government's General Services Administration or the IRS takes a number of its employees to Las Vegas for a conference, is this a taxable benefit (income) or not? The answer in this case is "no" because this is the type of benefit the political class enjoys. The questions are never-ending — e.g., sometimes parking fees are deductible and sometimes not, some charities are deductible and some are not — and hence, the opportunities for corruption and political bias are endless. Most of these questions will not go away with "tax reform" because they are inherent in an income-tax system.

The second reason that the IRS cannot be reformed is the type of individual who chooses to work for the agency. Some people have a passion to educate, so they become schoolteachers. Others have a passion to help people in trouble, so they become emergency first responders, doctors or other medical workers. Others want to help defend the country, so they join the military. Others want to design and build buildings, or just make money, so they become businessmen and quickly learn that the best way to make money is to provide goods and services that others need or desire. This is the beauty of the capitalistic system. It is win-win, because those who can provide the most-desired

goods and services at the best price can make the most money over the long run — by creating the most amount of happiness for their fellow man.

By contrast, the IRS is feared, loathed and resented. Thus, the IRS tends to attract all too many workers who are insensitive to the needs and problems of others, and some even enjoy being bullies. The tax code is so complex that no individual can understand it, including those who work for the IRS. That does not keep those who work there, though, from threatening everyone else for not understanding what they themselves do not understand. Many seem totally ignorant of the protections afforded by the U.S. Constitution and the American ideal of a civil society. The type of arrogant, mean-spirited, aggressive, biased and hypocritical incompetence by many IRS employees that has been revealed in the congressional hearings and other investigations would not be tolerated in most organizations.

Taxes are the necessary price for a civil society, but obtaining the revenue to operate the legitimate functions of government does not require an intrusive, destructive and easy-to-abuse income tax. A number of states and some foreign countries get along perfectly well without an income tax.

IRS misbehavior and abuse will not cease for the aforementioned reasons until the income tax is abolished. Moving to a flat tax would lessen the problem, but the potential for abuse will still occur. The long-term solution is to move to a system of user fees and consumption-based taxes, in which the opportunities for bias and abuse are minimized.

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