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Tax Reform in Plain English. Honest!

By Michael Kinsley

The triumphant republicans promise to make tax reform a high priority in the next few months. Democrats will have counterproposals. Here are some of the words you'll be hearing and how to interpret them.

Start with REFORM. Reform is any change in the tax code that you favor.

SIMPLIFY. The tax code is way too complicated, but proposals to simplify it should be regarded with suspicion — especially if they concentrate on tax rates. Different rates for different levels of income aren't what make the tax system complicated. The complications come in defining income and allowing various deductions and exemptions from it. Some of these complications could be eliminated in exchange for lower overall tax rates, but watch out for claims that tax simplification will lower your tax bill. If a simplified tax structure is going to raise the same amount of money, it can't lower everyone's taxes. Some will pay less, some will pay more. Sure, you'd like a simpler tax system, but would you like it even if it means higher taxes for you? If not, proceed with caution.

SUBSIDY. A tax subsidy is any deduction or exemption that you oppose. In the abstract, it is possible to separate tax-code complications that relate to fairness in the tax system from complications that have some nontax-related purpose, and to call the second type a subsidy. In practice, the distinction is harder. If a person earns \$100,000 and has \$20,000 in medical expenses, should he or she be taxed as someone who earns \$100,000 or as someone who earns \$80,000? Likewise, what about a person who earns \$100,000 and gives \$20,000 to charity? If you think the answer is \$80,000, then allowing this person a \$20,000 deduction is not a subsidy. If you think the answer is \$100,000, then any special treatment is a tax subsidy, and you must decide whether the subsidy is justified. If you think the answer is, "Well, I dunno, maybe somewhere in between, depending on this and that," you are probably right. And you can see why the income tax form will never be a postcard.

BURDEN. You'll be hearing a lot about the terrible burden of taxes — how it is greater than ever and how the rich are carrying a bigger share. We've been having this tax argument for a generation now, and for all that time — through Carter, Reagan, Bush, Clinton, Bush — the Federal Government has claimed about a fifth of the gross domestic product, never varying more than a percentage point or two. (It is state and local taxes that have soared.) Claims of fabulous benefit or terrible harm from alleged changes in the federal tax burden are hollow because there's been no evidence of either. The share of total income taxes being paid by the top 1% or 10%, or whatever slice you choose, has been increasing over the past couple of decades. But

the point to remember is that the top 1%'s or 10%'s share of total income has been increasing even faster than its share of income taxes. So its slice of the pie has been getting larger, not smaller.

Income tax statistics also hide a couple of important realities. One is the FICA or Social Security tax. Unlike the income tax, FICA applies to the first dollar you earn, but not to the 100,000th, and it isn't assessed on any investment income. The other reality is that income figures do not really reflect increases in wealth, most of which are tax free. Increases in the value of investments are not taxed until the investment is "realized" (i.e., sold). If you die without selling, the profit during your lifetime is never taxed. And when investment profit does get hit, it's usually at the lower, capital-gains tax rate.

INCENTIVE. This is any tax complication that you approve of. The term is invoked in favor of lower tax rates for certain (usually richer) people, for certain types of income (such as capital gains) and in general. It is undeniable that taxes discourage the activity being taxed, and that tax cuts encourage work and thrift and (if they're more narrowly focused) drinking more water on alternate Tuesdays in states beginning with W, and other fine things. But it is also undeniable that if you cut taxes on one activity or group of people, you must raise them on others to bring in the same amount of money.

If you believe in free markets, you ought to be dubious about focused tax incentives for one thing or another. The tax burden should be spread as evenly as possible across all the economic decisions a person has to make. An incentive to do one thing is a disincentive to do everything else. A tax break for a favored industry or activity isn't less government interference in the economy: it's more.

If a politician says that a pet tax break is so incentivizing that it will pay for itself, or that a bigger government deficit doesn't matter, ask yourself: Hey, in that case, why not lower tax rates to zero? Why torture ourselves with taxes at all? If you sense that there may be a flaw in that idea, ask yourself why a smaller version of the same idea isn't also flawed. If you don't sense a flaw, words are wasted on you.

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