

# Tax & Budget

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## Top Ten Civil Liberties Abuses of the Income Tax

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Any tax system creates a threat to individual liberty because “the power to tax involves the power to destroy,” as Chief Justice John Marshall observed.<sup>1</sup> But the federal income tax and its enforcement harm civil liberties much more than necessary to raise needed funds for the government. Certainly, the IRS performs poorly and too easily abuses the rights of citizens, but ultimately Congress is to blame for creating an excessively complex and high-rate tax system. New laws to increase taxpayer protections and replacement of the income tax with a simpler, flatter consumption-based tax could greatly reduce the following 10 areas of civil liberties abuse.

**1. “Vertical” Inequality.** Although equality under the law is a bedrock American principle, the income tax treats citizens very unequally. “Vertical” inequality is created by hugely different tax burdens on citizens at different income levels. For example, households earning between \$30,000 and \$75,000 pay an average 10 percent of their income in federal income taxes, compared to 27 percent for households earning more than \$200,000.<sup>2</sup> Fully 36 percent of U.S. households pay no income tax.<sup>3</sup> Besides violating the spirit of equal protection guarantees of the Constitution, such unequal burdens distort perceptions about the costs and benefits of government because programs appear to be free of cost to many.

**2. “Horizontal” Inequality.** Even people with similar incomes are treated unequally by the many exemptions, deductions, credits, and other intricacies of the income tax. For example, there are 59 income tax provisions that vary depending on marital status.<sup>4</sup> Likewise, the tax differences between homeowners and renters with the same incomes can be thousands of dollars because of itemized deductions for property taxes and mortgage interest. Another disparity is the unequal access to savings vehicles in the tax code depending on individuals’ work situations and other factors. If all individual savings were exempt from tax, as

under a consumption-based system, individuals would be treated more equally.

**3. Complexity, Ambiguity, and Uncertainty.** Certainty in the law is a bulwark against arbitrary and abusive government. But there is no certainty under the income tax because it rests on an inherently difficult-to-measure tax base, uses no consistent definition of “income” or other concepts, and is a labyrinth of narrow and limited provisions created by politicians intent on social engineering.<sup>5</sup> The current IRS commissioner concedes that the income tax has become too complex for accurate administration, which is evident in the 28 percent IRS error rate on phone inquiries and 60 percent error rate on audits.<sup>6</sup> Business tax rules are so ambiguous that many disputes drag on for years and are valued in the hundreds of millions of dollars.<sup>7</sup> Individuals are baffled by the complex rules on capital gains, pension and savings plans, and a growing list of targeted incentives. Those complexities would be eliminated under a flat consumption-based tax system.

**4. Huge Size and Instability of Tax Law.** Citizens are required to know the nation’s laws and comply with them. Yet federal tax rules are massive in scope and constantly changing. Tax laws, regulations, and related documentation span 45,662 pages.<sup>8</sup> There were 441 changes to tax rules in last year’s tax-cut law alone.<sup>9</sup> That law guaranteed a decade of tax instability with phased-in changes lasting until 2010. Income tax instability is typified by changes in taxes on capital. There have been 25 substantial changes in the treatment of long-term capital gains since 1922.<sup>10</sup> Pension tax laws have been substantially changed nearly every year since the early 1980s, creating regulatory backlogs and leaving employers unsure about how to comply.<sup>11</sup> Last year’s tax-cut law alone had 64 separate rule changes for pension and saving plans.<sup>12</sup>

**5. Lack of Financial Privacy.** The broad-based income tax necessitates a large invasion of financial privacy that a low-rate consumption-based tax could avoid. The IRS regularly gains access to a myriad of personal records, such as mortgage records, credit card data, phone records, banking and investment records, real property transaction data, and personal correspondence. This broad IRS authority to obtain records without court supervision has been referred to by the Supreme Court as “a power of inquisition.”<sup>13</sup>

**6. Denial of Due Process.** The Fifth Amendment right to due process is ignored in many respects by the federal income tax regime. Due process requires that government provide accused citizens a clear notice of a claim against them and allow the accused a hearing before executing enforcement action. But the IRS engages in many summary judgments, and enforces them prior to any judicial determinations. Moreover, the very complexity and ambiguity of the income tax seems to violate due process. In 1926, the Supreme Court noted that a statute that is “so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates that first essential of due process of law.”<sup>14</sup>

**7. Shifting of the Burden of Proof.** For non-criminal tax cases—the vast majority of cases—the tax code reverses the centuries-old common law principle that the burden of proof rests with the accuser. Except in some narrow circumstances, the IRS does not have to prove the correctness of its determinations. When the IRS makes erroneous assessments, as it often does, citizens carry the burden to prove that they are wrong. Efforts to shift the burden of proof to the IRS in the 1998 IRS Restructuring and Reform Act did not accomplish that goal. In addition, the new rules do not apply to the 97 percent of IRS actions that are deemed administrative in nature.<sup>15</sup>

**8. No Trial by Jury in Tax Court.** Despite Sixth and Seventh Amendment guarantees of trial by jury, the federal tax system carefully sidesteps such protections. To contest an IRS tax calculation prior to assessment, one must file a petition in the U.S. Tax Court. But since this is an administrative court, not an Article III court, no jury trial is required. To obtain a jury trial and related rights for civil tax cases, one must file suit in a U.S. District Court. But before that can happen, the alleged tax, penalties, and interest must be paid in full. And if the citizen wins, there is a burdensome route to retrieving the disputed money. For most people, those rules effectively eliminate the right to trial by jury in tax cases.

**9. Unreasonable Searches and Seizures.** In most situations, the Fourth Amendment guarantees that, before

the government can search private property and seize records, it must demonstrate to a court that there is “probable cause” to believe that lawless conduct exists. However, the IRS’s summons authority under tax code section 7602 allows it to obtain records of every description from any person without showing probable cause and without a court order. There has also been an explosion in information reporting required by the IRS and a big expansion in its computer searching for personal records. Recently, the IRS won the power to access financial data on Visa cards issued by foreign banks.<sup>16</sup> Many examples of abusive IRS searches and seizures were revealed in U.S. Senate hearings in 1997.

**10. Forced Self-Incrimination.** The requirement to file tax returns sworn to under penalty of perjury operates to invalidate the Fifth Amendment protection against self-incrimination. Citizens face a legal dilemma. On the one hand, refusing to file a return would expose a citizen to prosecution for failure to file. On the other hand, disclosing information sought in tax returns constitutes a waiver of Fifth Amendment protections. The IRS can and does release that information to federal, state, and local agencies for both tax and nontax law enforcement purposes.

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<sup>1</sup> *McCulloch v. Maryland*, 17 U.S. 316 (1819).

<sup>2</sup> IRS, *Statistics of Income Bulletin*, Fall 2001. Data are for 1999. Income concept is adjusted gross income.

<sup>3</sup> Joint Committee on Taxation, *JCS-1-02*, January 17, 2002, [www.house.gov/jct](http://www.house.gov/jct). Data are for 2001.

<sup>4</sup> Daniel J. Pilla, “A Monument of Deficient Wisdom,” Report no. 165, Institute for Policy Innovation, 2001, p. 15.

<sup>5</sup> Chris Edwards, “Simplifying Federal Taxes: The Advantages of Consumption-Based Taxation,” Cato Institute, October 2001.

<sup>6</sup> Pilla, p. 4.

<sup>7</sup> For example, in 1997 Columbia/HCA Corp. fought the IRS over a tax item worth \$267 million. The IRS ended up accepting \$71 million. *Tax Notes*, December 8, 1997, p. 1098.

<sup>8</sup> CCH, Inc., news release, January 14, 2000. This is the page count of the *Standard Federal Tax Reporter*, [www.cch.com](http://www.cch.com).

<sup>9</sup> “Tax Report,” *Wall Street Journal*, May 30, 2001, p. 1. Based on information from CCH, Inc.

<sup>10</sup> Edwards, p. 10.

<sup>11</sup> Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System*, vol. 2, p. 150, [www.house.gov/jct](http://www.house.gov/jct).

<sup>12</sup> Author's count.

<sup>13</sup> *United States v. Powell*, 379 U.S. 48, 57 (1964).

<sup>14</sup> *Connally v. General Construction Co.*, 269 U.S. 385 (1926).

<sup>15</sup> Pilla, p. 23.

<sup>16</sup> “Washington in Brief,” *Washington Post*, March 29, 2002, p. A11.