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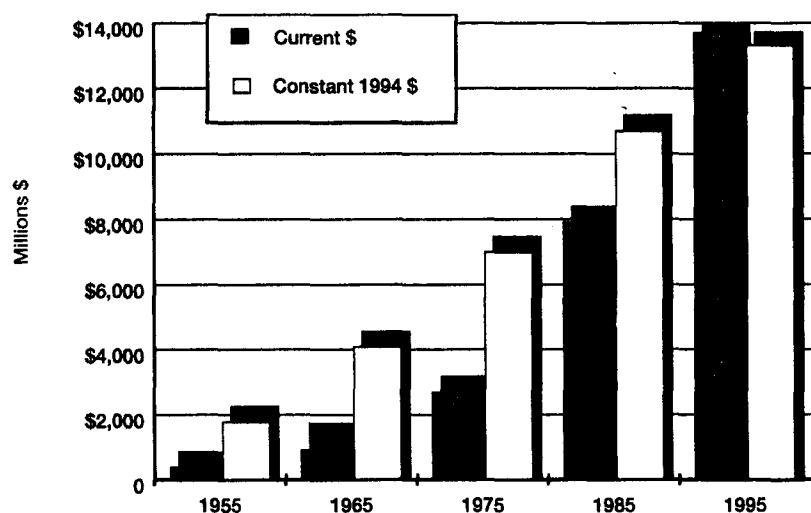
Growth of Federal Government Tax "Industry" Parallels Growth of Federal Tax Code

By Arthur P. Hall, Ph.D.
Senior Economist
Tax Foundation

For roughly the past half century Americans have witnessed frequent and dramatic changes in the federal government's tax system. Most of this change has taken place in the federal income tax. A permanent federal income tax was introduced after ratification of the 16th Amendment to the U.S. Constitution on February 3, 1913, and the tax played an important role in financing America's involvement in two world wars. Yet the substantial role the income tax plays today in the overall federal tax system can be traced to legislative efforts 40 years ago, when Congress undertook to make the income tax a cohesive and logical scheme through the Income Revenue Code of 1954.

Ever since the 1954 legislation, the federal income tax code has steadily grown in size and complexity. This growth has increased the cost of the federal tax system in two fundamental ways. First, taxpayers have had to earmark an ever-larger amount of tax dollars to the financing of the federal government tax "industry" (legislative, administrative, and judicial) that amends, administers, and adjudicates the federal tax system. Second, the growth of the federal tax system, particularly the growth in the income tax code, has forced the private economy to dedicate a substantial (and increasing) amount of resources to tax planning and the economically sterile exercise of tax compliance and litigation.

Figure 1
Budgetary Cost of Federal Government Tax "Industry," 1955-1995



Source: Tax Foundation compilation based on data from Office of Management and Budget; Clerk of the House; Secretary of the Senate; and agency annual reports.

Based on previously published Tax Foundation calculations, the total cost of complying with federal taxes for U.S. business will amount to an estimated \$127 billion in 1994. The cost of this activity for individuals may be as high as \$65 billion, bringing the total 1994 private sector cost of federal tax compliance to \$192 billion.

Personnel and Cost of the Federal Government Tax Industry

Figure 1 and Table 1 portray the growing cost of the federal tax industry. The inflation-adjusted budgetary costs of this industry will have grown by 650 percent between 1955 and 1995 (using the projections contained in the president's fiscal 1995 budget).

Table 1 also reports the number of people employed within the federal tax industry (excluding elected officials). The estimated 136,155 people that will be employed in 1995 represents a 114 percent increase over the estimated 63,712

people employed in 1955. In comparison, over the same time period the total number of income tax returns filed will have grown 159 percent, from 66.7 million to an estimated 173 million, while the total U.S. population has grown 59 percent, from 165.3 million to a projected 262.8 million.

The components of the federal government listed in *Table 1* represent an attempt to portray comprehensively (but not exhaustively) the federal government tax industry. When possible, the officially recorded total expenditures (wages/salaries plus all other administrative outlays) and personnel level of each agency has been listed. For example, the total personnel and expenditure levels of the Internal Revenue Service, Tax Court, and the Joint Committee on Taxation can be unambiguously allocated to the administration of the federal tax system. In some cases, however, the tax-related personnel and expenditures of the various agencies have been estimated. (Estimates are noted in *Table 1*.) For example, in the case of the Congressional Research Service and the General Accounting Office the proportion of total publications dedicated to tax-related topics was used to allocate the total

expenditure and personnel level of each agency. In the case of federal courts, the proportion of total tax-related cases was used. Similar proxies were used to estimate the expenditures of the other noted components of *Table 1*. As such, the personnel levels of the noted components—like the personal staff of members of Congress, for example—should be interpreted as full-time-equivalent employees, not actual people employed full time on tax-related matters.

Growth in the Federal Tax Code

The growth in the federal government tax industry parallels the growth in the federal tax code. It seems probable that the growth in the size and complexity of the tax code has promoted the growth in the tax industry. But one can also argue that the two elements reinforce each other. Complexity in the tax code creates the need for specialization among tax writers and regulators, and this specialization, in turn, breeds ever-more detailed rules for navigating the complexity. The general result is a tax code laden with detailed rules requiring an ever-increasing network of specialists to administer and amend the tax system.

Table 1
Federal Government Tax "Industry"
(Dollar Figures in Millions)

Component of Federal Government	1955		1965		1975		1985		1995	
	People	Dollars	People	Dollars	People	Dollars	People	Dollars	People	Dollars
Internal Revenue Service	50,890	\$290.74	60,360	\$706.81	82,616	\$1,959.04	96,705	\$6,746.47	109,656	\$9,860.75
Tax Court of the United States	141	1.14	164	2.09	194	11.03	294	18.88	350	35.60
Other Federal Courts (a)	218	1.71	376	4.78	434	11.11	399	20.95	1,089	95.99
Department of Treasury (b)	11,365	76.68	11,307	116.62	17,203	637.80	18,178	989.22	21,961	3,507.08
Department of Justice (Tax Division)	212	1.39	415	4.88	457	10.90	634	32.70	660	61.20
Senate Finance Committee	6	0.05	6	0.08	27	0.58	67	1.79	60	3.21
House Ways and Means Committee	22	0.03	22	0.05	47	0.40	102	4.94	143	8.42
Joint Committee on Taxation	27	0.20	27	0.33	47	1.18	74	3.58	73	6.48
Joint Economic Committee (a)	2	0.02	4	0.05	11	0.18	13	0.49	13	0.82
Personal Tax Staff of										
Members of Congress (a)	127	0.79	127	2.20	127	3.93	127	5.60	127	7.92
Government Printing Office (a)	188	1.23	2,590	61.12	3,250	32.23	1,344	18.59	1,095	32.47
General Accounting Office (a)	435	2.43	570	5.78	695	16.06	638	36.59	558	55.36
Congressional Research Service (a)	3	0.02	4	0.04	38	0.72	88	4.03	47	3.81
Congressional Budget Office (a)	0	0.00	0	0.00	0	0.00	15	1.12	15	1.62
Senate Budget Committee	0	0.00	0	0.00	15	0.33	95	2.61	73	3.09
House Budget Committee	0	0.00	0	0.00	75	1.48	119	4.73	109	6.09
Office of Management and Budget (a)	50	0.41	55	0.82	77	2.53	85	5.68	73	7.32
Other Parts of Executive Branch										
Council of Economic Advisers (a)	4	0.04	9	0.13	7	0.21	7	0.51	7	0.69
Bureau of Economic Analysis (a)	2	0.01	3	0.04	6	0.15	9	0.54	8	0.80
Bureau of the Census (Gen. of Gov'ts) (a)	20	0.09	20	0.15	7	0.28	19	1.01	38	2.52
Total	63,712	\$376.98	76,058	\$905.94	105,333	\$2,690.14	119,012	\$7,900.04	136,155	\$13,701.25
Period-to-Period Percent Growth	*	*	19.4%	140.3%	38.5%	196.9%	13.0%	193.7%	14.4%	73.4%
Inflation-Adjusted Percent Growth				130.6%		71.2%		53.0%		24.7%

(a) Estimated tax-related costs and personnel levels. Personnel levels should be interpreted as "full-time-equivalent" employees.

(b) Tax related, excluding IRS.

Source: Tax Foundation compilation based on data from Office of Management and Budget; Clerk of the House; Secretary of the Senate; and agency annual reports.

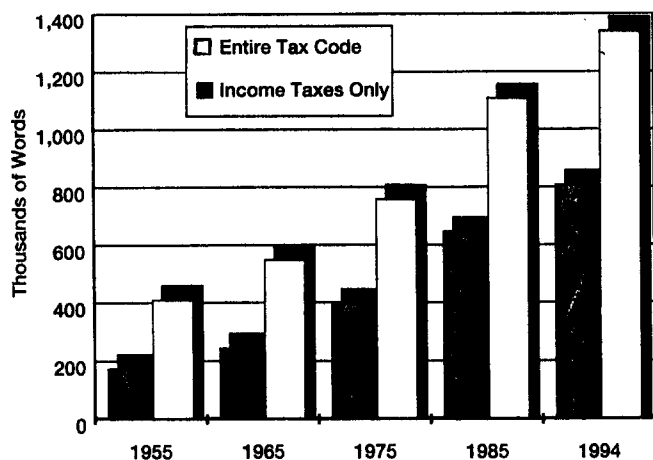
Table 2
Comparison of 1954 Code and 1986 Code (as of 1994)

Subchapter of Income Tax Code	Number of Sections in Subchapter		Percent Growth
	1954	1994	
Determination of Tax Liability	4	44	1000%
Computation of Taxable Income	9	145	1511
Corporate Distributions and Adjustments	14	35	150
Deferred Compensation	2	30	1400
Accounting Periods and Methods	6	33	450
Tax-Exempt Organizations	4	17	325
Corporations Used to Avoid Income Tax on Shareholders	4	27	575
Banking Institutions	3	20	567
Natural Resources	3	10	233
Estates, Trusts, Beneficiaries, Etc.	7	29	314
Partners and Partnerships	7	29	314
Insurance Companies	5	29	480
Regulated Investment Companies, Etc.	1	17	1600
Tax Based on Income from Within or Without the United States	9	78	767
Gain/Loss on Disposition of Property	7	42	500
Capital Gains and Losses	4	52	1200
Readjustment of Tax Between Years and Special Limitations	6	5	-17
Tax Treatment of S Corporations	0	14	NA
Other (a)	8	42	425
Total	103	698	578%

(a) Includes all subchapters not explicitly listed as well as Chapters 2-6 of Subtitle A of the Internal Revenue Code.

Source: Tax Foundation computations from Internal Revenue Code.

Figure 2
Growth in the Internal Revenue Code
(Estimated Number of Words)



Source: Tax Foundation.

Table 2 provides a crude but illuminating snapshot of the growth of the federal income tax code over the past 40 years. Organizationally, the Internal Revenue Code is broken into subchapters and sections, each covering a specific aspect of a tax or the treatment of a specific type of activity. The number of sections in the income tax code has increased by 578 percent, from 103 sections in the 1954 Code to 698 sections in the 1986 Code (as it is composed in 1994). Yet the fundamental tax goals of the code's subchapters has remained the same over time.

With the exception of two subchapters that have decreased in size, every subchapter contains substantially more sections. Of the subchapters with the highest percentage growth in the number of sections, four have significant practical and economic importance for a wide range of taxpayers: (1) Computation of Taxable Income, (2) Deferred Compensation (e.g., pension plans), (3) Capital Gains and Losses, and (4) Determination of Tax Liability. Each of these expanding subchapters has, by necessity, become integral to the process of financial planning for both individuals and businesses.

Table 3 attempts to provide more depth to the information in Table 2. It reports the growth in the estimated number of words that comprise the federal tax code and its attendant regulations.

Following the enactment of the 1954 Internal Revenue Code, Congress enacted significant tax legislation in 31 of the next 40 years. Although many of the enactments contributed to the complexity of the tax system, the Tax Reform Act of 1969 is commonly pinpointed as the legislation that infused serious complexity into the tax code, and the subsequent Acts have generally made matters worse.

In a simplistic way, this increased complexity is captured in Figures 2 and 3, which chart the growth in the volume of the tax code since 1955. The estimated number of words in the entire federal tax code grew 227 percent between 1955 and 1994. In contrast, the estimated number of words in the income tax code grew 369 percent over the same period. The growth in federal tax code regulations follows a similar pattern: Over the 1955-1994 period, the estimated number of words embodying the regulations for the entire federal tax code grew 457 percent, while the regulations relating to income taxes only grew 730 percent.

The growth of the federal income tax code relative to the entire code offers a key explanation for the growth of tax complexity and,

therefore, compliance costs. The income tax, an inherently complex tax because of the ambiguity associated with defining taxable income, has grown from representing 41 percent of the entire tax code in 1954 to representing 60 percent of the entire tax code in 1994, a 19 percentage point increase. The volume of income tax regulations has grown even more. In 1954, income tax regulations represented 55 percent of the body of federal tax code regulations. In 1994, that figure has grown to 83 percent, a 28 percentage point increase.

This differential in the growth of the income tax code versus the growth of income

tax regulations highlights an important element of tax code complexity: A brief paragraph of income tax legislation can be tremendously tedious to administer. A key example of this outcome can be found in Section 482, which gives the Secretary of the Treasury authority to allocate income and deductions among different business organizations which are owned or controlled by the same interests. The goal of such an allocation is to more clearly reflect actual income and thereby prevent tax evasion. Section 482 contains 127 words, but the regulations for Section 482 contain more than 19,000 words.

Table 3
Growth in the Internal Revenue Code as Measured by the Estimated Number of Words in the Code (Thousands)

	1955	1965	1975	1985	1994
Internal Revenue Code					
Income Taxes Only	172	243	395	645	807
Entire Tax Code	409	548	758	1,107	1,339
Period-to-Period Percent Growth					
Income Taxes Only	*	41%	63%	63%	25%
Entire Tax Code	*	34%	38%	46%	21%
Internal Revenue Code Regulations					
Income Taxes Only	572	1,715	2,571	3,762	4,750
Entire Tax Code	1,033	3,098	3,295	4,613	5,757
Period-to-Period Percent Growth					
Income Taxes Only	*	200%	50%	46%	26%
Entire Tax Code	*	200%	6%	40%	25%

Source: Tax Foundation calculations based on the annual publications of "Internal Revenue Code" and "Federal Tax Regulations" from West Publishing Company.

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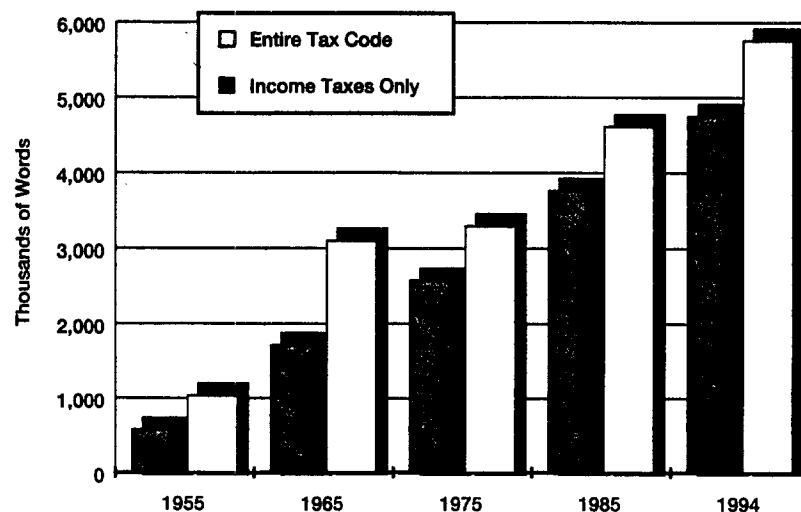
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Editor and Communications Director
Stephen Gold

Tax Foundation
1250 H Street, NW
Suite 750
Washington, DC 20005
(202) 783-2760

Figure 3
Growth in Internal Revenue Code Regulations (Estimated Number of Words)



Source: Tax Foundation.