New Tax Laws A Bizarre and Confounding Mix

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Economics can sometimes go round the bend. For instance, in theory, you could avoid the drawbacks of taxes—discouraging work and saving and encouraging tax shelters—by taxing people randomly. The idea is that you can't avoid taxes if you can't anticipate them. This ducky theory has never been tested. Before now.

Congress and the President have just enacted ten major tax changes over the next ten years—nine tax cuts and one whopping tax increase. Since these changes were legislated, people can see them coming and they aren't truly random. But even tax lawyers are bound to get confused about what's in store.

Here's a partial chronology of the madness:

2001: Manna from heaven. Starting this month, millions of checks will be mailed to the addresses where people lived last year. There will be news stories about people who moved and want their checks, and others about people who died but apparently still qualify for the Treasury's largesse. Madison Avenue will spend millions developing new ways to sell to that hard-to-reach dead demographic group. Your children will be worth $600 a piece in tax credits (up from $500 last year).

2002: The confusion begins in earnest. Middle-income people will file their tax returns and be surprised to discover that the much-heralded new 10-percent rate bracket does not exist. Instead, for one year only, you can claim a tax credit, which most people have already pocketed as a rebate check (see 2001). Those who didn't get the check will get to fill out a tax credit worksheet.

2003: The pope will express alarm about the spike in marriage annulments by couples who married in 2002 thinking that the marriage penalty had been eliminated. Middle-class marriage penalty relief does not start until 2005 and is not fully effective until 2009. It ends in 2011.

2005: Temporary relief from the ultra-complex alternative minimum tax "sunsets" and the AMT dragon returns with a vengeance. Eight million more taxpayers have to hire accountants to figure out their income taxes. The federal tax credit for state death taxes is repealed, so some estates will pay higher combined federal and state taxes than they would before estate tax relief was enacted. Your children are worth $700 each.

2006: The promised lower tax rates finally take effect (until 2011). Rich middle-aged men rush to take advantage of "fairness for women" provisions of the tax bill that allow people over 50 to contribute $5,000 extra to their pension plans. (Roughly three times as many men as women in that age group bump up against the current contribution limits.)

2007: The estate tax continues to linger, but grandpa is failing. Fortunately, the makers of the artificial heart have now created a device to replace all internal organs. The new Estate Tax Saver is guaranteed to keep grandpa legally alive until 2010.

2009: The Wall Street Journal runs an award-winning series titled "When to Pull the Plug on Grandpa" about the tax advantages of burying your lingering loved one this year and passing on capital gains tax free versus next year when the capital gains tax break is eliminated along with the estate tax. Your child is worth $800.

2010: Wealthy people respond in droves to the one-year "death holiday." The Estate Tax Savers are turned off, which is no surprise. What is surprising is the sight of thousands of seemingly healthy elderly Floridians marching into the sea on New Year's Eve. "It's for the children," says one septuagenarian before the undertow pulls her out to sea. Your children are worth $1,000.

2011: All of these changes and dozens more are reversed as the new law sunsets.

A dumb way to make tax policy? Sure, but the reality over the next decade is likely to be even worse. Congress and the President do not want their tax cuts to end one year after they finally take effect, but the country cannot afford to extend most of them. The recession and a stall in the new economy make rosy budget scenarios hard to justify. Without new revenues, politicians will have to decide which provisions to extend and which to truncate to finance the extenders.

Of course, were Congress subject to accounting standards and truth-in-advertising rules, it would have made those tough decisions before the mega-tax cut passed. We'd then have fewer tantalizing sound bites, but sounder tax policy and a better sense of what to expect in coming years.

Other Publications by the Authors

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