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Make Taxes Visible

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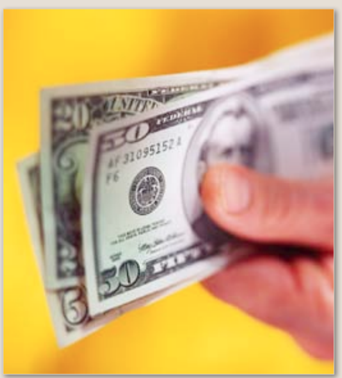
Here is an idea that should receive support from just about everyone: the taxpayer savings account (TSA). Instead of the current withholding system, amounts withheld from your paycheck would go into a segregated account that you own. Interest that accumulates would be yours to keep, instead of accruing to your employer or the government.



Dallas Headquarters:
12770 Coit Road, Suite 800
Dallas, TX 75251
972.386.6272
Fax: 972.386.0924

www.ncpa.org

Washington Office:
601 Pennsylvania Avenue NW,
Suite 900, South Building
Washington, DC 20004
202.220.3082
Fax: 202.220.3096

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The balance not needed for taxes would grow tax-free for your retirement or could be withdrawn tax-free for your personal consumption. Income taxes you owe would only be paid when they are due — on April 15. Social Security and other federal payroll taxes could also be put in the account, and remitted quarterly to the government.

Excess Tax Payments Are Interest-Free Loans to the Government. Under the current system, employers deposit employees' taxes in an interest bearing account until they are required to forward it the Treasury — monthly or semiweekly. While money is held in these accounts for a short period of time, the balance is constantly replenished as employees work and incur additional tax liabilities. Thus, in the course of a year, employers can earn a significant amount of interest income on income tax withholding. Employers also hold payroll taxes in these accounts prior to transferring the money to the federal government.

The tax payments forwarded to the federal government by employers are put in interest-bearing accounts at commercial banks throughout the country until needed, earning hundreds of millions of dollars in interest income for the federal government each year. In 2003, banks processed $1.58 trillion in tax payments held in these accounts.

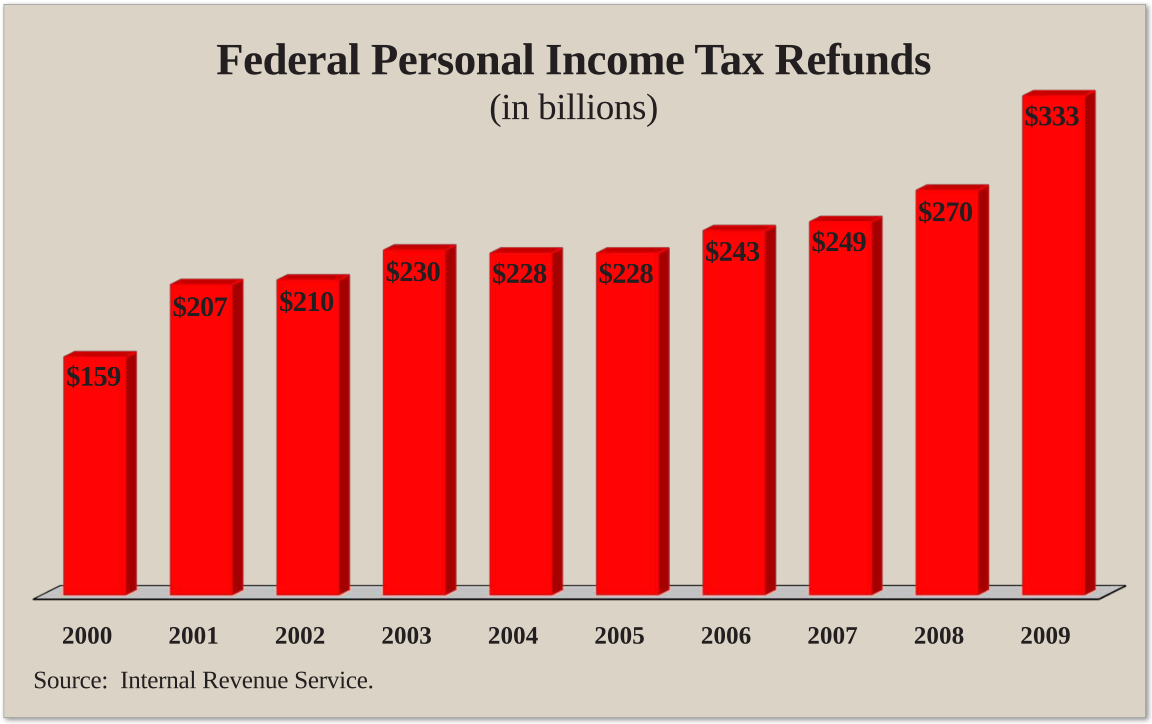
Tax Refunds: Heads the Government Wins; Tails, You Lose. Refunds to tax filers have more than doubled over the past 10 years, from $159 billion in 2000 to $333 billion in 2009. [See the figure.] Some taxpayers, particularly low-income workers who find it difficult to save, purposely over withhold in order to increase the size of their refund. Taxpayers also over withhold so they will not owe additional tax or penalty when they file their return.

While the government doesn't pay interest on excess tax payments, it does charge interest and penalties on the balance of taxes owed. If the amount of the deficiency is substantial, the taxpayer may be subject to "back-up" withholding in future years. This often means *over*-withholding to ensure that the government is paid. However, the average refund amount is relatively small. The average refund for 2006, for example, was $2,224 — including refundable tax credits paid to people with no income tax liability.

Many Tax Filers Pay to Receive a Refund. Many taxpayers pay for the privilege of getting back their excess tax payments. Tax filers who qualify for a refund often pay exorbitant implicit interest rates to receive refund anticipation loans

(RALs) from such tax preparers as H&R Block. According to a 2008 Government Accountability Office Report:

- In 2005, 9.6 million taxpayers applied for RALs totaling $28.7 billion.
- The total interest and fees charged by sample of tax preparers visited by GAO investigators amounted to annual percentage rates ranging from 36 percent to more than 500 percent.



Taxpayers pay the fees and interest but receive a refund check just a few weeks or days before they would if they filed their returns electronically and had their refund check deposited electronically. Further, if the refund amount calculated is based on inaccurate information from the taxpayer, the individual is liable for the unpaid tax, with whatever penalties and interest the IRS adds.

Taxpayer Savings Accounts. The current withholding system distorts individual perception of tax liability. Your money is automatically whisked away from each paycheck, and most folks receive only their "take-home" pay. Then, when their final tax liability is computed, they rejoice when they receive their tax "refund," which is simply the excess of taxes they paid throughout the year. Of course, they can envision their tax liability from their return. But the psychological impact is distorted by the "refund" process.

Imagine a country where each taxpayer has a Taxpayer Savings Account. It could earn a modest return. The taxpayer could see that the TSA contains his/her money. If the taxpayer does qualify for a refund, it could be direct-deposited into the account. Because the refund has already been taxed (along with any additional funds in the account) the TSA functions like a Roth retirement account — the balance in the account and cumulative interest earned would never be taxed again!

What's Good for the Geese. Every April 15, when an individual's tax payment is due, he/she would likely have to transfer the bulk of the deposits made the previous year to the government instead. This would cause the taxpayer's attention to shift dramatically from what he gets back from the government (a refund) to what the government costs him.

The current system obfuscates how much government costs. Jean-Baptiste Colbert, the French minister of finance in the late 1700s, famously quipped: "The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing." And so it is.

The current tax withholding and quarterly tax payment system was enacted as a "temporary" war measure during World War II. Soon it became clear that withholding made paying taxes less painful. The pain of a single, large transfer of money was ameliorated by plucking on the installment plan. This procedure dulls the average taxpayer to the cost of government.

Think how much better it would be for democratic decision-making if taxpayers were made clearly aware of how much government costs them.

Michael Whalen is the policy chairman of the National Center for Policy Analysis and the president and chief executive of Heart of America Restaurants & Inns.