



Taxes And Psychology: Americans Got A Tax Cut, Even If They Don't Believe It

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Polls show that the majority of Americans don't think their taxes were cut with the landmark tax cut and reform bill signed into law by President Donald Trump in December 2017.

But just in time for tax day, the *New York Times* published a well-written and counter-intuitive analysis by two of their economics reporters, Ben Casselman and Jim Tankersley. In it, the reporters note that only 40% of Americans believed their taxes were cut, while less than one in ten filers actually paid more in taxes.

The journalists then made a remarkable observation:

To a large degree, the gap between perception and reality on the tax cuts appears to flow from a sustained — and misleading — effort by liberal opponents of the law to brand it as a broad middle-class tax increase.”

Reality differs from perception: regardless of their feelings, most Americans saw their taxes go down, not up.

In fact, according to The Tax Policy Center, only 6% of filers paid more taxes, while 65% paid less on their 2018 income.

But there's another culprit in this Caper of the Grand Misperception. It's the psychology of payroll tax withholding.

Income tax withholding started as a wartime measure in World War II. In one of the biggest ironies of history, a young government economist by the name of Milton Friedman came up with the idea. Decades later, Dr. Friedman himself lamented:

“It never occurred to me at the time that I was helping to develop machinery that would make possible a government that I would come to criticize severely as too large, too intrusive, too destructive of freedom.”

Withholding does this by taxing people beneath the threshold of observation. People work. People get paid. And the government extracts their income taxes before the payroll check even makes it into the bank.

The government sees withholding's stealth as a feature, not a bug. The Department of the Treasury, a bit of remarkable honesty, once noted on its website that withholding:

...greatly reduced the taxpayer's awareness of the amount of tax being collected, i.e. it reduced the transparency of the tax, which made it easier to raise taxes in the future."

This, of course, was Friedman's fear of withholding—what taxpayers don't notice, they won't complain about.

A key feature of 2017's tax cut was a reduction of payroll tax withholding. Most working Americans enjoyed a small boost to their take home pay. As a result, when it came time to file their taxes, in many cases, they saw a smaller tax refund.

Receiving a smaller refund from the Internal Revenue Service doesn't mean you paid more taxes or even less taxes—it simply means you didn't give the U.S. government as large an interest-free loan for the prior year. Unfortunately, far too many taxpayers view a tax refund as a gift when all it really means is that the government sending back some of the money it took in the first place.

From a political standpoint, it would have been smarter, though less efficient, if the new tax law had sent tax cut checks to every taxpayer, as was done in 2001 under President Bush.

Imagine instead what Tax Day might be like if we had no payroll withholding at all— if taxpayers could gain a sudden and deep understanding of the federal government's income tax levy. They'd see it in its full force and might likely develop different attitudes about the size and scope of government.

In contrast, up until last year, we had a tax system where about 3 in 4 filers got money back from the government, either because they didn't owe income taxes and receive an Earned Income Tax Credit (EITC) from the government or because they had too much money withheld from their paycheck during the prior year's earnings. This distorts public opinion about the nature of federal taxes.

As the Cato Institute's Dan Mitchell, a tax and fiscal policy expert, noted, "The fact that people are looking forward to tax time rubs me the wrong way. I would like them to be upset."

Sadly, people are upset this year—upset because they erroneously think their taxes went up when they went down.