The Curse of the Withholding Tax

04/21/2005[Laurence M. Vance]

Did you have to write out a check to the IRS for $5,581 this past April 15? If you had to do such a thing next year, would you think of it as your civic duty or would you consider it a crime that only the government could get away with?

A Typical Taxpayer

This figure of $5,581 is not an arbitrary one. According to the U.S. Census Bureau, real median household income was $43,318 for 2002 and 2003. A taxpayer with an income of that amount who was single with no children would, after his standard deduction of $4,850 and his personal exemption of $3,100, owe $5,581 in federal income tax for tax year 2004. If this same taxpayer was married and his spouse did not work, he would be entitled to an extra personal exemption, thus lowering his tax liability to $3,399—still a huge sum for most Americans to come up with.

If this same couple were to have a child, they would gain not only another personal exemption, but also a $1,000 child tax credit. However, their tax liability would still be $1,934—an amount that the typical American does not have in his checking account. The addition of another child would lower this couple's tax liability down to $469.

The Withholding Tax

But regardless of the amount of federal income tax that one ultimately pays, the fact that the U.S. government seizes the wealth of its citizens slowly over the course of the year via the withholding tax means that the typical taxpayer is comfortable in each of the above scenarios because he doesn't actually have to write out a check to the government on April 15 of each year.

The withholding tax makes it possible for the government to silently steal the wealth from its citizens with little or no outrage about the loss. And even in the case where the citizen receives a refund of all the taxes he has paid in, the withholding tax still serves two evil purposes. First, getting a refund of all the taxes one pays in amounts to an interest-free loan to the government. The government gets money to continue its spending orgy, and the citizen loses the ability to receive a return on money that could be invested. And second, getting a tax refund fosters the notion that the government is benevolent. Never mind that the money is yours. If the government sends you a check in the mail then the government can't be all that bad.

If the $5,581 were gradually taken out of one's paycheck over the course of the year and no money was owed on April 15, the pain of the theft would be greatly diminished, but for two entirely different reasons. Obviously, it is less painful to have $107.33 taken out of one's check every week for fifty-two weeks than writing a check to the government for that amount every week or a check for the whole amount once a year. The second reason the pain of the $5,581 loss would not readily be felt is that very few people pay any attention to the amount of taxes that are withheld from their pay. They are concerned only with their take-home pay. This is unfortunate because if the people who pay taxes actually realized how much the government was taking from them they would be outraged.

The Origin of Tax Withholding

So where did the withholding tax come from? It was not part of the original income tax that resulted from the sixteenth amendment in 1913. Very few people paid any taxes back then anyway. The income tax did not directly affect the average American until World War II.

On the eve of the war, few Americans paid income taxes. Those that owed taxes paid them in one lump sum on March 15 (later changed to April 15). To pay for the war, the Revenue Act of 1942 lowered exemptions and raised income tax rates. But it also did something even more insidious—it instituted a 5 percent "Victory Tax" on all wages above an exemption of $624. The tax was to be collected by the employer and deducted from the employee's paycheck—just like the Social Security tax that began in 1935.

The Current Tax Payment Act of 1943 then revolutionized the income tax by making withholding taxes universal. The withholding tax was part of the new tax plan offered by Beardsley Ruml (1894–1960), the chairman of the New York Federal Reserve Bank and treasurer of R.H. Macy and Co. By 1945, about three-fourths of Americans were paying federal income taxes. And although the withholding tax was sold as a wartime emergency, like most expansions of government instituted during wartime, it has been a way of life for most Americans ever since.

The Curse of the Withholding Tax

The income tax allows the government to confiscate the wealth of its citizens. The curse of the withholding tax is that it allows the government to commit this crime systematically, effortlessly, painlessly, and benevolently.

Surprisingly, it was a free market economist who helped the federal government implement the withholding tax in the first place. As was pointed out by the Austrian economist, Murray Rothbard (1926–1995), in his 1971 article "Milton Friedman unraveled":

One of Friedman's most disastrous deeds was the important role he proudly played, during World War II in the Treasury Department, in foisting upon the suffering American public the system of the *withholding* tax. Before World War II, when income tax rates were far lower than now, there was no withholding system; everyone paid his annual bill in one lump sum, on March 15. It is obvious that under this system, the Internal Revenue Service could never hope to extract the entire annual sum, at current confiscatory rates, from the mass of the working population. The whole ghastly system would have happily broken down long before this. Only the Friedmanite withholding tax has permitted the government to use every employer as an unpaid tax collector, extracting the tax quietly and silently from each paycheck. In many ways, we have Milton Friedman to thank for the present monster Leviathan State in America.

Conclusion

Ideally, the elimination of the withholding tax would force the American people to see exactly how much of their income is being confiscated by the government to fund its trillion-dollar budgets. This would, of course, have to be followed by sufficient outrage on behalf of the American people to reduce those budgets. The elimination of the withholding tax is also sometimes seen as freeing businesses from being tax collectors. But this would only be true if businesses also ceased to collect Social Security tax for the government.

But on a more practical note, there are two reasons why even if the withholding tax were eliminated it might not result in sufficient enough outrage at the level of government wealth confiscation and spending. First, the majority of the population presently pays little or no income tax. It is of no consequence to them if the "rich" have money withheld from their paychecks or not. And second, many out of this majority are not only *not* taxpayers, they are taxeaters who benefit from the redistribution of the wealth of those who actually pay taxes. The continued expansion by the Republicans in Congress of refundable tax credits like the Earned Income Tax Credit and the Additional Child Tax Credit will ensure that the number of taxeaters will increase.

There is also one significant practical consideration that cannot be ignored. The chance that Congress would ever eliminate that which provides the government with a continual flow of revenue is zero. There is, therefore, nothing short of dramatically rolling back income tax rates (good) or eliminating the income tax altogether (better) that will even begin to tame the federal leviathan.

Author:

Contact Laurence M. Vance

Laurence M. Vance is an Associated Scholar of the Mises Institute, columnist and policy adviser for the Future of Freedom Foundation, and a columnist, blogger, and book reviewer at LewRockwell.com. He is also the author of *Gun Control and the Second Amendment*, *The War on Drugs Is a War on Freedom*, and *War, Empire and the Military: Essays on the Follies of War and U.S. Foreign Policy*. His newest books are *Free Trade or Protectionism?* and *The Free Society*. Visit his website: www.vancepublications.com.

Image source:
commons.wikimedia.org