# NOTE

# THE CASE FOR OVER-WITHHOLDING FEDERAL INCOME TAX: BENEFITS TO LOW-INCOME TAXPAYERS*

Susannah Kroeber†

Abstract

*The W-4 tax withholding form has been used by individual taxpayers for decades to calculate their tax withholdings. It is based, however, on the faulty assumption that most U.S. workers have a single source of income. This assumption has caused millions of taxpayers to incur unnecessary tax debt. The formula for calculating federal income tax withholding for employees routinely under-withholds for low-income workers who have multiple sources of income because, without substantial documentation and calculation by the employee, employers withhold as if they are the employee's single source of income. Taxpayers may therefore see their income tax withheld at too low a marginal rate, oftentimes zero percent, and can have significant balances due on short notice at the end of the tax year.*

*This Note documents that reality and proposes a solution. It proposes a reconception of the Form W-4 and the withholding formula through the lens of low-income filers and aims for a policy of over-withholding from those filers in order to reduce surprise tax due and related penalties. The proposed solution removes the bias towards achieving a "zero refund" from the form design by eliminating the tax-free threshold—for most filers, the equivalent of their standard deduction—from the withholding scheme. As discussed in the Note, the proposed policy would also have the benefit of increasing tax compliance, minimizing bureaucratic burdens, and providing a revenue-neutral solution for the government. This Note further suggests an extension of the proposed policy to provide a much-needed savings mechanism for low-income filers.*



* This Note received an Honorable Mention in the Theodore Tannenwald Jr. Foundation Excellence in Tax Scholarship Writing Competition in 2020.

† Columbia Law School, J.D. Candidate '21.

## I. TAX ISSUES FOR WORKERS WITH MULTIPLE W-2S

Imagine a taxpayer who has two employers and earns less than the standard deduction at each job. When this taxpayer is hired, she is presented with multiple tax forms by each employer, including a W-4 to specify tax withholdings. She may even note that she should be factoring in the income received from each job, but can't understand how, and neither of her employers view it as their job to provide guidance on how to account for other forms of employment. She tries to use the Internal Revenue Service (IRS) tools, but those provide no specific instructions for how to fill out the forms for her situation. As a result, she fills out each form without accounting for her other source of income and neither employer withholds any federal income tax. When she files her return, she finds out that she owes hundreds of dollars, perhaps over a thousand—an amount that, like most Americans, she does not have. This is hardly theoretical; because of the default rules in our federal income tax withholding regime, this is the reality for many taxpayers every year.

After the end of each calendar year, Americans who earn income receive a variety of tax documents, including documents that detail their earnings and tax withholdings. The process of completing a tax return, for most people, involves collecting these documents and preparing and filing a return between the end of the year and April 15, Tax Day.[1] When a filer has a single source of income as an employee, this process is relatively straightforward. The single source of income is reported on a W-2, along with the tax that was withheld each pay period throughout the year. The filer then reports that income and either pays a balance or receives a refund. However, a disconnect occurs when filers have multiple sources of income. If a taxpayer fails to accurately predict future income or adjust their withholdings with their employer with every change to income and life circumstance, the withholding amounts can vary wildly from the actual tax owed. This is particularly true for low-income filers with more than one source of income and can result in far too little income being withheld. This Note will examine the tax compliance difficulties for low- and middle-income filers with multiple sources of wage income, and propose policy solutions to change the default withholding rules to reduce surprise tax debt for those filers.

While the IRS and the Bureau of Labor Statistics (BLS) do not publish data on how many different sources of wage and independent contractor income taxpayers report on their returns, there is reason to believe that is a substantial number. A BLS study found that Americans born in the 1980s held an average of 8.2 jobs between the ages of 18 and 32.[2] The study also found that earners aged 25 to 32 with less than a high school education saw more than half of those jobs end in under a year, while those with a college degree held jobs for less than a year at close to half that rate.[3] Even factoring in that workers with less education were likely to experience weeks of unemployment, the number of jobs held suggests an average of seven job changes for young American workers between the ages of 18 and 32. This suggests that in at least half of the calendar years young taxpayers are reporting multiple sources of income. This does not even take into account the likelihood of holding multiple jobs simultaneously, which would increase the number of years in which multiple income sources are reported on a return.

### A. The Impact of Multiple Form W-4s on Tax Due

The current tax system relies on a combination of forecasted earned income, reported on the Form W-4, and end of year income, reported through the Form W-2. The Form W-4 requires individual taxpayers to project their expected earned income for the tax year, which is in turn translated into amount of tax withheld over the course of the year. This has led to a situation where many filers of all income levels discover only after the end of the tax year that they have mis-withheld. For those who discover they have over-withheld and are entitled to a refund, this comes as welcome news. In fact, in analogous situations, low-income filers even have a preference for receiving cash transfers through their tax refunds rather than through welfare programs.[4] However, when filers find to their

---

[1] In 2020, the IRS postponed Tax Day for all filers to July 15, 2020, due to the COVID-19 pandemic. This delayed filers' obligation to prepare and submit their returns and to make any necessary payments by 90 days. *Filing and Payment Deadline Extended to July 15, 2020 - Updated Statement*, IRS (Mar. 21, 2020) https://www.irs.gov/newsroom/payment-deadline-extended-to-july-15-2020 [https://perma.cc/C6D5-65PE]. In 2021, the IRS again postponed Tax Day, this time by 32 days to May 17, 2021. *Tax Day for Individuals Extended to May 17: Treasury, IRS Extend Filing and Payment Deadline*, IRS (Mar. 17, 2021), https://www.irs.gov/newsroom/tax-day-for-individuals-extended-to-may-17-treasury-irs-extend-filing-and-payment-deadline [https://perma.cc/DG37-AEAL].

[2] *Americans at Age 33: Labor Market Activity, Education and Partner Status Summary*, U.S. BUREAU OF LAB. STATS. (May 5, 2020), https://www.bls.gov/news.release/nlsyth.nr0.htm [https://perma.cc/KA6A-8PU8].

[3] *Id.*

[4] Sara Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair,* 88 N.Y.U. L. REV. 515, 538-43 (2013).

surprise that they owe tax, reactions vary from disgruntled to despondent.[5] For many, a refund is an annual opportunity to engage in large spending events, such as home improvements or vehicle repairs. For others, it is an opportunity to add to savings or pay down debt—only a small minority use their refunds for daily expenses.[6] When taxpayers find to their surprise that they are not only not receiving a refund, but that they in fact owe the government back-taxes, they are forced to tap into their already scant savings, and are unable to engage in the financially responsible activities that they would have otherwise.

Taxpayers across income brackets prefer refunds, and while some would prefer a net $0 refund, only a small minority of taxpayers desire the outcome of owing the government money.[7] However, by 2019, after the implementation of the 2017 Tax Cuts and Jobs Act, filers were seeing almost imperceptible increases in take-home pay (0.3 percent to 0.4 percent), which resulted in substantially lower refunds, an average decrease of 8.9 percent, due to changes in the income tax withholding formula.[8] This also resulted in more people owing the IRS money than in prior years. The misalignment between this outcome and a preference for refunding rather than imposing a tax bill,[9] as well as the public's nearly unanimous desire to receive tax refunds, needs to be resolved. This Note proposes a solution to address surprise tax bills due and also considers using withholdings as a tool for forced savings for low- and middle-income taxpayers.

B. Background on the Form W-2

The Form W-2 is designed to inform workers of their aggregate earnings, tax withholdings, and other adjustments to income.[10] It is issued after the end of each calendar year by the employer to the employee and the employer separately submits the information to the IRS.[11] When an employee files their tax return, they must use the information on the W-2 to report their earnings, which the IRS may then compare to the information submitted by the employer.[12] A W-2 is issued to all employees who hold an employee status for tax purposes with their employer—other reporting mechanisms are used for independent contractors.[13] The key distinction between taxpayers who are issued W-2s as opposed to

---

[5] Michelle Singletary, *Taxpayers Cry '#TaxScam' as Total Refunds are Down by $6 Billion*, WASH. POST (Apr. 11, 2019), https://www.washingtonpost.com/business/2019/04/11/taxpayers-cry-taxscam-total-refunds-are-down-by-billion/ [https://perma.cc/6TM8-8XMC].

[6] Darla Mercado, *Here's What People are Doing with Their Tax Refunds*, CNBC (Mar. 5, 2020), https://www.cnbc.com/2020/03/05/heres-what-people-are-doing-with-their-tax-refunds.html [https://perma.cc/86DS-V4DP].

[7] Kay Bell, *Do You Want a Big Tax Refund or Bigger Paycheck?,* BANKRATE (Mar. 12, 2015), https://www.bankrate.com/finance/consumer-index/money-pulse-0315.aspx [https://perma.cc/8EPX-SEN5].

[8] John W. Schoen & Darla Mercado, *Average Tax Refund is Down 8.7 Percent from a Year Ago*, CNBC (Feb. 14, 2019), https://www.cnbc.com/2019/02/14/average-tax-refund-is-down-8point7-percent-from-year-ago.html [https://perma.cc/Y7XM-WCSE].

[9] *See infra* Part **Error! Reference source not found.** (imposing federal sanctions for significant under-withholding evidences IRS preference for over-withholding to minimize any potential tax due).

[10] *See About Form W-2, Wage and Tax Statement*, IRS (Dec. 11, 2020), https://www.irs.gov/forms-pubs/about-form-w-2 [https://perma.cc/BW5T-P9K2].

[11] *Topic No. 752 Filing Forms W-2 and W-3,* IRS (Jan. 25, 2021), https://www.irs.gov/taxtopics/tc752 [https://perma.cc/V99J-WKH3].

[12] *2021 Form W-2, Instructions for Employee*, IRS, https://www.irs.gov/pub/irs-pdf/fw2.pdf [https://perma.cc/9HE4-KKR5] (last visited on Apr. 4, 2021).

[13] Note that the distinction between an employee and an independent contractor, while using the same terminology, differs in the tax and labor law contexts. *See Understanding Employee vs. Contractor Designation*, IRS (July 20, 2017), https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation [https://perma.cc/8PKR-XWLC]. *See also Fact Sheet #13: Employment Relationship Under the*

other tax documents associated with earned income is that this group is subject to automatic tax withholdings through their employer.[14] Independent contractors, by contrast, receive 1099-MISC forms with no automatic withholdings and must make estimated tax payments on a quarterly basis.[15] The information on a W-2 is employer-specific. Employees with multiple sources of income will receive W-2s or other income reporting documents from each employer annually. An employee is required to calculate the impact of earnings from each source of employment on the others. The atomized nature of income reporting and tax withholdings will almost certainly lead to a balance owed to the IRS or refunded to the taxpayer at the end of each year.

C. Background on the Form W-4

When income is withheld from an employee's paycheck, it is done on the basis of information provided by the employee on the Form W-4. The Form W-4, the "Employee's Withholding Certificate" (formerly the "Employee's Withholding Allowance Certificate"), is used by filers to notify their employers of their tax situation and is used by the employer to calculate taxes to be withheld from the employee's salary.[16] If an employee does not file a W-4, or the employer does not properly adjust based on a submitted W-4, the employer is required to use a default withholding scheme and withhold as if the taxpayer files as single and takes the standard deduction.[17] While this default generates a higher amount withheld than other filing options based solely on filing status and dependents, it is often insufficient to cover tax owed for filers with multiple sources of income.

An unusual characteristic of the W-4 is that the user has some discretion in filling out the form. There are no penalties for incorrectly filling out the form, but if a filer fails to withhold enough to cover their tax bill, penalties may be imposed.[18] For example, a filer can use the form to over-withhold—have their employer take more from their paycheck than would be indicated by their earnings—and use their annual refund as a deliberate method for savings. A filer can also choose to fill out the form to most accurately reflect their earnings, in an attempt to minimize their refund or balance owed with their tax return. However, it is nearly impossible for a taxpayer who owes federal income tax to relay enough information on the W-4 to generate a zero return—a tax return with no refund or balance owed. This is because of the variety of credits and deductions that many taxpayers are eligible for, along with the interplay of state and federal taxes, and the relative inscrutability of the W-4 itself.

---

*Fair Labor Standards Act (FLSA)*, U.S. DEP'T OF LAB., WAGE & HOUR DIV. (July 2008), https://www.dol.gov/agencies/whd/fact-sheets/13-flsa-employment-relationship [https://perma.cc/2Y34-25K9].

[14] *Tax Withholding*, IRS (Apr. 8, 2021), https://www.irs.gov/payments/tax-withholding [https://perma.cc/E3P2-GJ78].

[15] *See Self-Employed Individuals Tax Center*, IRS (Mar. 17, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/self-employed-individuals-tax-center [https://perma.cc/ZK84-4A75].

[16] *About Form W-4, Employee's Withholding Certificate*, IRS (Dec. 15, 2020), https://www.irs.gov/forms-pubs/about-form-w-4 [https://perma.cc/S8RS-G4X6].

[17] *Topic No. 753 Form W-4 – Employee's Withholding Certificate*, IRS (Mar. 9, 2021), https://www.irs.gov/taxtopics/tc753 [https://perma.cc/2GUJ-X4W8].

[18] *Topic No. 306 Penalty for Underpayment of Estimated Tax*, IRS (Mar. 5, 2021), https://www.irs.gov/taxtopics/tc306 [https://perma.cc/52GB-B4DD] [hereinafter IRS, *Topic No. 306*].

### *1. Form Design: Comparison of the Pre-2020 Form W-4 to the Current Form W-4*

The Treasury Department and the IRS made substantial changes to the W-4 form for the 2020 tax year,[19] which the IRS stated were necessary due to the removal of personal and dependent exemptions under the 2017 tax reform.[20]

There are three broad complaints about the pre-2020 version of the W-4 form ("old form"): (1) lack of clarity about the impact of withholdings on the refund amount, (2) counterintuitive allowance numbering to the amount of money withheld, and (3) inability to assess withholdings for filers with multiple income streams. While the 2020 version of the W-4 ("new form") addresses all of these issues in some way, none of the remedies are fully adequate.

[19] *See* Figures 1 and 2.

[20] *IRS, Treasury Issue Proposed Regulations Updating Income Tax Withholding Rules*, IRS (Dec. 17, 2020), https://www.irs.gov/newsroom/irs-treasury-issue-proposed-regulations-updating-income-tax-withholding-rules [https://perma.cc/RMB6-SPEJ].

**Figure 1: Form W-4, 2019, "old form."**

## Form W-4 (2019)

**Future developments.** For the latest information about any future developments related to Form W-4, such as legislation enacted after it was published, go to *www.irs.gov/FormW4*.

**Purpose.** Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes.

**Exemption from withholding.** You may claim exemption from withholding for 2019 if **both** of the following apply.

- For 2018 you had a right to a refund of **all** federal income tax withheld because you had **no** tax liability, **and**
- For 2019 you expect a refund of **all** federal income tax withheld because you expect to have **no** tax liability.

If you're exempt, complete **only** lines 1, 2, 3, 4, and 7 and sign the form to validate it. Your exemption for 2019 expires February 17, 2020. See Pub. 505, Tax Withholding and Estimated Tax, to learn more about whether you qualify for exemption from withholding.

### General Instructions

If you aren't exempt, follow the rest of these instructions to determine the number of withholding allowances you should claim for withholding for 2019 and any additional amount of tax to have withheld. For regular wages, withholding must be based on allowances you claimed and may not be a flat amount or percentage of wages.

You can also use the calculator at ***www.irs.gov/W4App*** to determine your tax withholding more accurately. Consider using this calculator if you have a more complicated tax situation, such as if you have a working spouse, more than one job, or a large amount of nonwage income not subject to withholding outside of your job. After your Form W-4 takes effect, you can also use this calculator to see how the amount of tax you're having withheld compares to your projected total tax for 2019. If you use the calculator, you don't need to complete any of the worksheets for Form W-4.

Note that if you have too much tax withheld, you will receive a refund when you file your tax return. If you have too little tax withheld, you will owe tax when you file your tax return, and you might owe a penalty.

**Filers with multiple jobs or working spouses.** If you have more than one job at a time, or if you're married filing jointly and your spouse is also working, read all of the instructions including the instructions for the Two-Earners/Multiple Jobs Worksheet before beginning.

**Nonwage income.** If you have a large amount of nonwage income not subject to withholding, such as interest or dividends, consider making estimated tax payments using Form 1040-ES, Estimated Tax for Individuals. Otherwise, you might owe additional tax. Or, you can use the Deductions, Adjustments, and Additional Income Worksheet on page 3 or the calculator at *www.irs.gov/W4App* to make sure you have enough tax withheld from your paycheck. If you have pension or annuity income, see Pub. 505 or use the calculator at *www.irs.gov/W4App* to find out if you should adjust your withholding on Form W-4 or W-4P.

**Nonresident alien.** If you're a nonresident alien, see Notice 1392, Supplemental Form W-4 Instructions for Nonresident Aliens, before completing this form.

### Specific Instructions

#### Personal Allowances Worksheet

Complete this worksheet on page 3 first to determine the number of withholding allowances to claim.

**Line C. *Head of household please note:*** Generally, you may claim head of household filing status on your tax return only if you're unmarried and pay more than 50% of the costs of keeping up a home for yourself and a qualifying individual. See Pub. 501 for more information about filing status.

**Line E. Child tax credit.** When you file your tax return, you may be eligible to claim a child tax credit for each of your eligible children. To qualify, the child must be under age 17 as of December 31, must be your dependent who lives with you for more than half the year, and must have a valid social security number. To learn more about this credit, see Pub. 972, Child Tax Credit. To reduce the tax withheld from your pay by taking this credit into account, follow the instructions on line E of the worksheet. On the worksheet you will be asked about your total income. For this purpose, total income includes all of your wages and other income, including income earned by a spouse if you are filing a joint return.

**Line F. Credit for other dependents.** When you file your tax return, you may be eligible to claim a credit for other dependents for whom a child tax credit can't be claimed, such as a qualifying child who doesn't meet the age or social security number requirement for the child tax credit, or a qualifying relative. To learn more about this credit, see Pub. 972. To reduce the tax withheld from your pay by taking this credit into account, follow the instructions on line F of the worksheet. On the worksheet, you will be asked about your total income. For this purpose, total

---------------------------- **Separate here and give Form W-4 to your employer. Keep the worksheet(s) for your records.** ----------------------------

Form **W-4**
Department of the Treasury
Internal Revenue Service

## Employee's Withholding Allowance Certificate

► **Whether you're entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.**

OMB No. 1545-0074

**2019**

| | | |
|---|---|---|
| 1 Your first name and middle initial | Last name | 2 **Your social security number** |
| Home address (number and street or rural route) | 3 ☐ Single ☐ Married ☐ Married, but withhold at higher Single rate. **Note:** If married filing separately, check "Married, but withhold at higher Single rate." | |
| City or town, state, and ZIP code | 4 **If your last name differs from that shown on your social security card, check here. You must call 800-772-1213 for a replacement card.** ► ☐ | |

5 Total number of allowances you're claiming (from the applicable worksheet on the following pages) . . . . 5

6 Additional amount, if any, you want withheld from each paycheck . . . . . . . . . . . . . . . 6 $

7 I claim exemption from withholding for 2019, and I certify that I meet **both** of the following conditions for exemption.

- Last year I had a right to a refund of **all** federal income tax withheld because I had **no** tax liability, **and**
- This year I expect a refund of **all** federal income tax withheld because I expect to have **no** tax liability.

If you meet both conditions, write "Exempt" here . . . . . . . . . . . . . . . . ► 7

Under penalties of perjury, I declare that I have examined this certificate and, to the best of my knowledge and belief, it is true, correct, and complete.

**Employee's signature**
(This form is not valid unless you sign it.) ► **Date** ►

| | | |
|---|---|---|
| 8 Employer's name and address (**Employer:** Complete boxes 8 and 10 if sending to IRS and complete boxes 8, 9, and 10 if sending to State Directory of New Hires.) | 9 First date of employment | 10 Employer identification number (EIN) |

**For Privacy Act and Paperwork Reduction Act Notice, see page 4.** Cat. No. 10220Q Form **W-4** (2019)

**Figure 2: Form W-4, 2020, "new form."**

Form **W-4**
Department of the Treasury
Internal Revenue Service

**Employee's Withholding Certificate**
▶ **Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.**
▶ **Give Form W-4 to your employer.**
▶ **Your withholding is subject to review by the IRS.**

OMB No. 1545-0074
**2020**

**Step 1: Enter Personal Information**

(a) First name and middle initial | Last name | **(b) Social security number**

Address

City or town, state, and ZIP code

▶ **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.

(c)
☐ **Single or Married filing separately**
☐ **Married filing jointly** (or Qualifying widow(er))
☐ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

**Complete Steps 2–4 ONLY if they apply to you; otherwise, skip to Step 5.** See page 2 for more information on each step, who can claim exemption from withholding, when to use the online estimator, and privacy.

**Step 2: Multiple Jobs or Spouse Works**

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.

Do **only one** of the following.

**(a)** Use the estimator at *www.irs.gov/W4App* for most accurate withholding for this step (and Steps 3–4); **or**

**(b)** Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; **or**

**(c)** If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld . . . . . ▶ ☐

**TIP:** To be accurate, submit a 2020 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.

**Complete Steps 3–4(b) on Form W-4 for only ONE of these jobs.** Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3–4(b) on the Form W-4 for the highest paying job.)

**Step 3: Claim Dependents**

If your income will be $200,000 or less ($400,000 or less if married filing jointly):

Multiply the number of qualifying children under age 17 by $2,000 ▶ $

Multiply the number of other dependents by $500 . . . . ▶ $

Add the amounts above and enter the total here . . . . . . . . . . . . . . **3** $

**Step 4 (optional): Other Adjustments**

**(a) Other income (not from jobs).** If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income . . . . . . . . . . . . **4(a)** $

**(b) Deductions.** If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here . . . . . . . . . . . . . . . . . . . . . . **4(b)** $

**(c) Extra withholding.** Enter any additional tax you want withheld each **pay period** . **4(c)** $

**Step 5: Sign Here**

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

▶ **Employee's signature** (This form is not valid unless you sign it.) ▶ **Date**

**Employers Only**

Employer's name and address | First date of employment | Employer identification number (EIN)

**For Privacy Act and Paperwork Reduction Act Notice, see page 3.** Cat. No. 10220Q Form **W-4** (2020)

a. Impact of Withholdings on Refund Amount

The old Form W-4s provided only a short explanation of their utility, which did not explain the repercussions of the form on the taxpayer's refund: "Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes."[21] For the 2020 form redesign, this explanation was expanded to include a

[21] *Supra* Figure 1.

discussion of the impact of the form on a filer's refund, adding the following information: "If too little is withheld, you will generally owe tax when you file your tax return and may owe a penalty. If too much is withheld, you will generally be due a refund."[22] What "too little" and "too much" means is different for each filer, however, and is not explained anywhere on the form or in the instructions.

b. Counterintuitive Allowances

The old form used a system of allowances to calculate tax withholdings that roughly corresponded to personal exemptions on the filer's tax return. For example, a single filer might claim themselves and list "1" as the number of allowances, while a family of four might have listed "4." Discretionary additions or subtractions to this number could cause this number to deviate from the number of exemptions claimed on a tax return.[23] For example, if you were claiming the child tax credit, the number of allowances per child would differ depending on your income. However, these determinations could only be made by carefully following instructions on an accompanying worksheet. In many instances, the taxpayer was required to know what their earnings for the year would be in advance of earning them. Additionally, one of the most common W-4 errors under the old form was mistaking the allowance number as a scale of how much would be withheld—but in the opposite direction—when, in fact, as the allowance number increased, it decreased the number of dollars withheld. This counterintuitive system meant that many filers who did not understand the form simply put a high number for their allowances, mistakenly believing that this would ensure they had withheld enough to be entitled to a refund at the end of the year, only to discover that the exact opposite was true after it was too late to adjust.[24]

The 2017 Tax Cuts and Jobs Act eliminated the system of personal exemptions in favor of a simplified higher standard deduction.[25] As a result, the Treasury Department and the IRS issued a revised W-4 in 2019 for the 2020 tax year to take into account the changes under the new law, and ostensibly to create a more streamlined and user-friendly form.[26] While the counterintuitive numbering system has been removed, the new form now requires more engagement from the filer. Under the old W-4, a filer always had the option to enter "0" allowances and know that the maximum base amount would be withheld.[27] There is no clear method to achieve the same result and over-withhold on the new form. The only indicator of withholding status is filing status (single, married filing jointly, head of household), which cannot be overridden by simply entering "0" allowances, as had been available in the old form. This mechanism has instead been replaced with

[22] *Supra* Figure 2.

[23] Form W-4 (2019), IRS 3, https://www.irs.gov/pub/irs-prior/fw4--2019.pdf [https://perma.cc/E8NH-HSSD] (last visited Apr. 4, 2021).

[24] Scott R. Schmedel, *A Form of Confusion*, CHI. TRIB. (June 26, 1997), https://www.chicagotribune.com/news/ct-xpm-1997-06-26-9706260446-story.html [https://perma.cc/Y7ZK-WR2Y].

[25] Erica York, *The Tax Cuts and Jobs Act Simplified the Tax Filing Process for Millions of Households*, TAX FOUND. (Aug. 7, 2018), https://taxfoundation.org/the-tax-cuts-and-jobs-act-simplified-the-tax-filing-process-for-millions-of-americans/ [https://perma.cc/73C3-REYX]; *see* I.R.C. § 151(d)(5).

[26] *Treasury and IRS Issue Improved Form W-4 for 2020 to Simplify Filing and Increase Transparency*, U.S. DEP'T TREASURY (Aug. 9, 2019), https://home.treasury.gov/news/press-releases/sm753 [https://perma.cc/6RQA-XLAL].

[27] For outdated advice on claiming "0" allowances, see *How Many Allowances Should I Claim On Form W-4?*, LIBERTYTAX (Mar. 30, 2016), https://www.libertytax.com/tax-lounge/how-many-allowances-should-i-claim-on-form-w/ [https://perma.cc/67BA-HXC4]. Both the old and the new forms also have the option to add an additional fixed-dollar amount to be withheld per pay period. *Supra* Figures 1 and 2.

three different options for calculating withholdings based on multiple jobs, two of which require worksheets or a visit to a webpage and a third, which provides a separate section for claiming dependents. All of these options require knowledge of future earnings, as well as significant interaction with the form and associated worksheets or websites.

c. Multiple Sources of Income

The most significant change between the two W-4 forms is the addition of a new section for those with multiple sources of income and married couples who both work. While this is a commendable change, the complexity of the process to accurately report earnings—which requires adjustment of the form with each employer every time a wage or employment situation changes—creates a significant tax compliance burden on filers.[28] Only the simplest scenario requires no additional calculation: two jobs with similar pay. But even this requires some care and guesswork from the taxpayer, as it requires matching forms to be submitted to each employer, and there is no guidance for what "similar" means.

*2. Scope of Impact: Single and Head of Household Filers*

There are two classes of workers who are uniquely vulnerable to large, unexpected taxes due to withholding issues: single filers with no dependents, and head of household filers with dependents aging out of eligibility. Because of the peculiarly American habit of conducting social welfare through the tax code,[29] for some workers, particularly those with dependents, tax owed is offset by cash distributions through the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC). For those workers, the windfall of the refundable credits will likely erase any tax owed.[30] The EITC is much more generous to families with children and the CTC is targeted only at filers claiming children.[31] While this might mute the distributive effect of these credits, it does mean that for low-income families who receive these benefits, large tax balances emerging suddenly at the end of the year are relatively unusual.

Workers who do not claim children on their tax return are left without the buffer of these refundable credits. For single filers with no dependents, the EITC pays out a maximum of $538 and phases out at $15,820 of income.[32] Single filers benefitted from the tradeoff in the 2017 tax reform law due to the increase in the standard deduction at the expense of the elimination of personal exemptions, which likely helped to reduce the surprise tax bills due for very low wage workers by increasing their tax-free threshold. However, for low wage workers in the $20,000 to $40,000 annual gross income range, the 2017 tax law only benefitted them to the tune of $180 to $360 in reduced taxes, an increase

---

[28] Ann Carrns, *Check Out the New W-4 Tax Withholding Form. Really.*, N.Y. TIMES (Dec. 13, 2019), https://www.nytimes.com/2019/12/13/your-money/new-w-4-form.html [https://perma.cc/7YKT-CBBP].

[29] *See Social Policy and the Tax System*, URBAN INSTITUTE 4 (June 21, 2001), https://www.urban.org/sites/default/files/publication/59926/310418-Social-Policy-and-the-Tax-System.PDF [https://perma.cc/FG3S-QECY]; Adriene Hill, *Why So Much of the U.S. Tax Code is Social Policy*, MARKETPLACE (Oct. 2, 2017), https://www.marketplace.org/2017/10/02/why-so-much-us-tax-code-social-policy-0/ [https://perma.cc/7AQ9-CGPK].

[30] *See infra* Table 3: Taxpayer $1_A$ & Table 5: Taxpayer $2_A$.

[31] Thomas L. Hungerford & Rebecca Thiess, *The Earned Income Tax Credit and the Child Tax Credit*, ECON. POL'Y INST. 2-3 (Sept. 25, 2013), https://files.epi.org/2013/The-Earned-Income-Tax-Credit.pdf [https://perma.cc/XP82-WYW5].

[32] *Earned Income and Earned Income Tax Credit (EITC) Tables*, IRS (Feb. 3, 2021), https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-tax-credit-income-limits-and-maximum-credit-amounts [https://perma.cc/J6SS-YP44].

of less than 1 percent in net income.[33] Small increases in income from multiple sources or a change in the type of income, from wage to independent contractor income, is likely to have a large impact on the tax burden of these workers.[34] This is especially true for low-income filers for whom payroll taxes account for 7.65 percent of income,[35] a much higher percentage of their total tax bill relative to those in higher income brackets.

Head of household filers present a peculiar subset of the above group. Although this group benefits from the EITC and CTC benefits while they have minor children, those benefits evaporate when their dependents age out of eligibility. Unlike married couples filing jointly, head of household filers lose their tax-preferred filing status, which creates a simultaneous drop in tax-free income of nearly a third, at the same time that their eligibility for credits disappears. While many filers are aware that their EITC and CTC benefits will be reduced or eliminated when their children grow up, few are aware of how the change in filing status will impact their income. Yet, the IRS does no outreach regarding the impact of the change in status and only warns taxpayers of the ramifications of the reduction or elimination of EITC and CTC benefits.[36] A mere change in filing status, which amounts to a $6,250 decline in tax-free income, can increase a taxpayer's tax owed by $625 to $1,375 for those in the first three tax brackets (up to over $97,000 in annual income).[37]

**Table 1: 2020 Income Tax Brackets[38]**

| **Rate** | **For Single Individuals, Taxable Income Over** | **For Married Individuals Filing Joint Returns, Taxable Income Over** | **For Heads of Households, Taxable Income Over** |
|---|---|---|---|
| **10%** | $0 | $0 | $0 |
| **12%** | $9,875 | $19,750 | $14,100 |
| **22%** | $40,125 | $80,250 | $53,700 |
| **24%** | $85,525 | $171,050 | $85,500 |
| **32%** | $163,300 | $326,600 | $163,300 |
| **35%** | $207,350 | $414,700 | $207,350 |
| **37%** | $518,400 | $622,050 | $518,400 |

[33] Danielle Kurtzleben, *CHARTS: See How Much of GOP Tax Cuts Will Go to the Middle Class*, N.P.R. (Dec. 19, 2017), https://www.npr.org/2017/12/19/571754894/charts-see-how-much-of-gop-tax-cuts-will-go-to-the-middle-class [https://perma.cc/WF73-NF2D].

[34] *See infra* Table 2: Taxpayer 1 & Table 4: Taxpayer 2: single, middle-income filer.

[35] *Topic No. 751 Social Security and Medicare Withholding Rates*, IRS (Feb. 5, 2021), https://www.irs.gov/taxtopics/tc751 [https://perma.cc/6U5A-B433] (payroll tax is comprised of a 6.2 percent Social Security tax plus a 1.45 percent Medicare tax).

[36] *See EITC Awareness Day*, IRS (Dec. 28, 2020), https://www.eitc.irs.gov/partner-toolkit/eitc-awareness-day/eitc-awareness-day-2 [https://perma.cc/A4J9-C2VS].

[37] *See infra* Table 1. Reduction in tax-free income is derived from the difference between the standard deduction for Head of Household ($18,650) filers and the standard deduction for Single filers ($12,400). The difference in tax owed is calculated by applying the differential tax rates from Table 1.

[38] Income in this table refers to taxable income, which is gross income minus the standard deduction or the itemized deductions that the taxpayer is claiming. I.R.C. § 63.

Thirty-nine percent of Americans do not have $400 of savings on hand to deal with an emergency.[39] Due to the complexity of our tax system, and the ways it changes annually for individuals, but does not announce the impact of those changes until the end of a calendar year, low-income individuals are uniquely vulnerable to being thrust into tax balances owed and, subsequently, tax debt.

## II. A NEW WITHHOLDING REGIME FOR AN ECONOMY OF UNSTABLE INCOMES ACROSS MULTIPLE JOBS: DELIBERATE OVER-WITHHOLDING

The key presumptions made by the W-4 form—even in the new 2020 iteration—are that all taxpayers can predict what their incomes will be prospectively; income changes will be infrequent; filers will adjust their withholdings every time they experience a change in their income; and employers will correctly follow the instructions on the W-4 when filing. This belies the realities for low-wage workers, who are not only more likely to hold multiple jobs within a tax year and be unable to predict their income with accuracy,[40] but also are less equipped for the compliance costs of adjusting their withholdings.

The policy proposal in this Note suggests a simpler solution: create a default withholding structure that eliminates the need for W-4 use (and misuse) for low- and middle-income workers by deliberately over-withholding federal income tax. This will produce the joint benefits of reduced surprise tax bills due, and a new default savings vehicle for taxpayers who are least likely to have any savings at all.

### A. Why Over-Withholding for Wage Workers?

Wage workers need over-withholding to (1) remediate the problem of chronic under-saving by low-income workers; (2) ensure the full benefits of social credits such as the EITC and CTC are felt; (3) encourage better tax compliance; and (4) prevent low-income individuals with no savings from accruing unnecessary surprise tax bills.

#### *1. Withholdings as an Accessible Option for Savings for Low-Income Individuals*

The conventional wisdom states that over-withholding deprives workers of income to pay for necessary expenses in the present, while the government benefits from over-withholding in the form of a no-interest loan from taxpayers as income is withheld over the course of the tax year.[41] This analysis ignores that all individuals need an option for savings in order to pay for large expenses. Many low-income taxpayers lack access to traditional savings or checking accounts[42] and taxpayers that do have access to the traditional banking system are not benefitting from significant interest income throughout the tax year. Interest rates for savings accounts in consumer banks, used by low- and

---

[39] FEDERAL RESERVE BOARD, REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2018 2 (2020), https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf [https://perma.cc/C8FN-LNDF].

[40] Jonnelle Marte & Lucia Mutikani, *Share of U.S. Workers Holding Multiple Jobs is Rising, New Census Report Shows*, REUTERS (Feb. 17, 2021), https://www.reuters.com/article/us-usa-economy-multiple-jobs/share-of-u-s-workers-holding-multiple-jobs-is-rising-new-census-report-shows-idUSKBN2AH2PI [https://perma.cc/PZ63-AL46].

[41] *See infra*, Part **Error! Reference source not found.**.

[42] *See* MICHAEL S. BARR, BROOKINGS INST., BANKING THE POOR: POLICIES TO BRING LOW-INCOME AMERICANS INTO THE FINANCIAL MAINSTREAM 4 (2004), https://www.brookings.edu/wp-content/uploads/2016/06/20041001_Banking.pdf [https://perma.cc/7KR3-NRRH].

middle-income taxpayers, average 0.04 percent.[43] Thus, withholdings creates an accessible savings option for certain low-income taxpayers and, for others, shifts the savings mechanism from negligible interest-bearing savings accounts to withholdings with no significant detriment to those taxpayers.

Instead, tax withholdings should be viewed through the lens of forced savings. Middle- and high-income individuals benefit from tax-preferred forced savings in the form of 401(k)s and can opt into programs such as IRAs or 529 plans for college savings, but low-income individuals are less likely to have access to such tax-preferred vehicles.[44] Low-income individuals are also less likely to have a savings account, or a bank account in general.[45] Even if access to consumer banking were to improve, the policy behind 401(k)s and other forms of forced saving still holds. All people are more likely to save, develop wealth, and better withstand disaster if there are default savings mechanisms in place.[46]

One of the key aspects of such forced savings programs is that they are intended to be long-term savings vehicles. To further that goal, participants lose access to deposited funds or incur a significant penalty if they attempt to access the funds early. Early withdrawal from tax-preferred accounts like 401(k)s and traditional IRAs require taxpayers to pay a 10 percent penalty on the withdrawal as well as income taxes owed.[47] This deters early withdrawal and helps individuals maintain their retirement accounts for the intended purpose of retirement, rather than other savings.

In contrast, tax withholdings are available on an annual basis to the taxpayer, but provides no option for early withdrawal. It is similar to the concept of a lending circle,[48] except that it is partially within an individual's control what that final payout will be and there is no risk-sharing. Instead, tax withholdings can, and already do, operate as a savings vehicle for low-income individuals to make large purchases on an annual basis.[49] Furthermore, low-income families after the Clinton-era welfare reform increasingly depend on high interest credit cards to weather financial shocks.[50] Rather than disincentivizing consumer spending, tax withholdings allows individuals and families to budget based on a slightly reduced take-home pay, with the security of knowing that they are saving for larger purchases when the time is right. Additionally, given the gaps in consumer banking—where low-income individuals often cannot access no-fee checking accounts[51]—the federal government offers taxpayers a free and secure place to store their earnings.

[43] Lauren Perez, *What Is the Average Interest Rate for Savings Accounts?*, SMARTASSET (Feb. 25, 2021), https://smartasset.com/checking-account/average-savings-account-interest [https://perma.cc/5VWS-XHEY].

[44] Jeff Schwartz, *Rethinking 401(k)S*, 49 HARV. J. ON LEGIS. 53, 69 (2012).

[45] Barr, *supra* note 42, at 4.

[46] James J. Choi, et al., *For Better or for Worse: Default Effects and 401(k) Savings Behavior*, in PERSPECTIVES ON THE ECONOMICS OF AGING 81, 83 (David A. Wise, ed., 2004).

[47] *Topic No. 558 Additional Tax on Early Distributions from Retirement Plans Other than IRAs*, IRS (Mar. 17, 2021), https://www.irs.gov/taxtopics/tc558 [https://perma.cc/US3Q-VLS6].

[48] Mary Ager Caplan, *Communities Respond to Predatory Lending*, 59 SOC. WORK 149, 153 (2014).

[49] Mercado, *supra* note 6.

[50] Sternberg Greene, *supra* note 4, at 548. Post-welfare reforms, low-income families saw an increase in credit card debt of 184 percent relative to the period before those reforms. TAMARA DRAUT & JAVIER SILVA, BORROWING TO MAKE ENDS MEET: THE GROWTH OF CREDIT CARD DEBT IN THE '90S (2003), https://www.demos.org/sites/default/files/publications/borrowing_to_make_ends_meet.pdf [https://perma.cc/88MV-6YYZ].

[51] Barr, *supra* note 42, at 4.

a. Under-Withholding Causes Surprise Tax Balances That Low-Income Filers Do Not Have the Resources to Pay

For some filers, over-withholding may not be the answer to increasing savings, but it could be the answer to reducing taxes owed. As discussed above, low-income and middle-income filers with multiple sources of income, wage or otherwise, are more likely to owe taxes when they file. This is a demographic already unlikely to have savings significant enough to pay any amount of tax due in a lump sum at the time of filing, and payment plans are expensive. A quarter of filers use their refunds to pay down debt, particularly high interest credit card debt.[52]

For low-income filers with little to no savings, there are added costs of being unable to make a payment in full by the filing deadline—in effect a tax levied by the IRS on those who lack savings. Currently, it costs between $31 and $225 simply to set up a payment plan for a duration of longer than 120 days with the IRS,[53] and the interest rate has ranged from 3 percent to 6 percent for individuals over the past five years.[54] For the nearly half of Americans who would struggle to find $400 for an emergency expense, the added burden of administrative costs creates another barrier to paying down tax due or tax debt.[55]

b. State and Federal Sanctions for Non-Payment

Individuals who find themselves with surprise tax bills due may also accrue additional monetary and non-monetary penalties. For large balances owed (which includes balances exceeding $1,000, less than 90 percent of estimated tax paid in advance, or less than 100 percent of the tax owed in the prior tax year paid in the current tax year), the IRS may issue a fine, compounding the tax balance already owed.[56] Most states that levy income tax have similar systems for fining or charging interest to those who underpay.[57] States and the federal government also can engage in wage garnishment for unpaid taxes, with states varying in whether they are more or less protective than the federal government.[58] Some states also use other tools to penalize filers who have unpaid tax debt,

[52] Mercado, *supra* note 6.

[53] *Additional Information on Payment Plans*, IRS (Feb. 19, 2021), https://www.irs.gov/payments/payment-plans-installment-agreements [https://perma.cc/7T4H-V9C9] (expand dropdowns for "Long-term Payment Plan (Installment Agreement)").

[54] *IRS Penalty & Interest Rates*, INTUIT ACCTS., https://proconnect.intuit.com/articles/federal-irs-underpayment-interest-rates/ [https://perma.cc/VLN3-AUH6] (last visited on Apr. 3, 2021).

[55] Neal Gabler, *The Secret Shame of Middle-Class Americans*, ATLANTIC (2016), https://www.theatlantic.com/magazine/archive/2016/05/my-secret-shame/476415/ [https://perma.cc/9Y97-C7GC].

[56] *Notice 746, Information About Your Notice, Penalty and Interest*, IRS (Jun. 2020), https://www.irs.gov/pub/irs-pdf/n746.pdf [https://perma.cc/66X3-WHFD].

[57] *See, e.g.*, *Interest and Penalties*, N.Y. STATE DEP'T OF TAX'N & FIN. (DEC. 7, 2020), https://www.tax.ny.gov/pit/file/interest_and_penalties.htm [https://perma.cc/D2VC-R5XZ] (penalties in New York State); *Estimated Connecticut Income Taxes*, CONN. STATE DEP'T OF REVENUE SERVS, https://portal.ct.gov/DRS/Publications/Informational-Publications/1992/IP-9254-Estimated-Connecticut-Income-Taxes [https://perma.cc/M9FJ-FMRY] (interest payments in Connecticut); *Penalty Reference Chart*, CAL. FRANCHISE TAX BD. (2012), https://www.ftb.ca.gov/forms/misc/1024.html [https://perma.cc/5GDU-JPXU] (penalties in California).

[58] *Information About Wage Levies*, IRS (Sept. 20, 2020), https://www.irs.gov/businesses/small-businesses-self-employed/information-about-wage-levies [https://perma.cc/8BW7-DWUF]; *compare* Patricia Dzikowski, *New York Wage Garnishment Law*, NOLO, https://www.nolo.com/legal-encyclopedia/new-york-income-execution-wage-garnishment-law.html [https://perma.cc/XM3V-S7T8] (last visited Apr. 4, 2021) *with* Hari Ender, *Illinois Wage Garnishment Law*, NOLO, https://www.nolo.com/legal-encyclopedia/illinois-wage-garnishment-law.html [https://perma.cc/PL3B-TBXQ] (last visited Apr. 4, 2021) (Illinois has a more protective regime than New York State).

often using methods completely apart from the tax system, such as suspending driver's licenses.[59]

### *2. Tax Compliance Increases with Refunds and Reduces Bureaucratic Burdens on Low-Income Filers*

The benefits of over-withholding are not limited to individual filers. The IRS could increase revenue and decrease enforcement costs by changing the default withholding structure to increase the number of filers facing gains rather than losses from their tax returns. This in turn would decrease the compliance costs and bureaucratic burdens on low-income filers.

#### a. Tax Compliance

One of the greatest challenges for low-income filers is the constantly changing landscape of tax regulation and the relatively few procedural protections for filers who cannot afford robust legal advice.[60] Additionally, low-income filers are justified in their perception that enforcement is unequal across income classes. As the IRS has scaled back enforcement across income brackets, the rate of audits for EITC recipients—definitionally low-income, with the median recipient earning $20,000 annually—has dropped by only about a third, compared to approximately 80 percent declines for earners over $200,000.[61] This has translated to a comparable audit rate of the poorest and the richest Americans.[62] This is a reversion to the pre-Great Recession mean: in the late 1990s and early 2000s, a taxpayer earning $25,000 was more likely to be audited than a taxpayer making more than $100,000.[63]

While disproportionately imposing tax enforcement on the poorest Americans, the IRS has ignored one of its most powerful tools to increase compliance: tax refunds.[64] Multiple analyses have found that knowing that a refund is likely on the back end makes taxpayers more likely to engage in tax-compliant behavior on the front end.[65] In particular, under-withholding has a direct impact on revenue.[66] Filers who face a balance owed are more likely to attempt to reduce their tax liability than those who face a refund. Such behavioral differences are measurable;[67] if all filers facing refunds attempted to minimize tax liability in the same manner as those facing balances owed, the IRS would lose $3.7 billion in revenue; if the reverse were true, the IRS would gain $1.4 billion.[68] In other words, the IRS would be able to increase revenue simply by changing withholding guidelines and allowing taxpayers to face refunds, rather than balances owed.

---

[59] *Driver's License Suspension*, N.Y. STATE DEP'T OF TAX'N AND FIN. (July 31, 2019), https://www.tax.ny.gov/enforcement/collections/driver-license-susp.htm [https://perma.cc/9ZYL-V9TL].

[60] Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 U. KAN. L. REV. 1145, 1148 (2003).

[61] Paul Kiel, *It's Getting Worse: The IRS Now Audits Poor Americans at About the Same Rate as the Top 1%*, PROPUBLICA (May 30, 2019), https://www.propublica.org/article/irs-now-audits-poor-americans-at-about-the-same-rate-as-the-top-1-percent [https://perma.cc/58A4-HEE4].

[62] *Id.*

[63] Book, *supra* note 60, at 1158.

[64] Daniel Hemel, *Tax Refunds Are More Than a Boost to Your Bank Account—They're Good for the Country, Too*, TIME (Feb. 14, 2019), https://time.com/5529647/tax-refunds/ [https://perma.cc/EM5M-PWNK].

[65] Gideon Yaniv, *Tax Compliance and Advance Tax Payments: A Prospect Theory Analysis*, 52 NAT'L TAX J. 753, 762 (1999); PAUL WEBLEY, *ET AL.*, TAX EVASION: AN EXPERIMENTAL APPROACH 83 (1991).

[66] Hemel, *supra* note 64.

[67] *Id.*

[68] Alex Rees-Jones, *Quantifying Loss-Averse Tax Manipulation*, 85 REV. ECON. STUD. 1251, 1253 (2018).

Simultaneously, the IRS would also be able to reduce enforcement infrastructure—and with it, reduce its operational budget—if fewer taxpayers were engaging in tax-minimization behavior.

b. Bureaucratic Burden

Tax compliance is probably the phrase most synonymous with "burden" in the American psyche. This is particularly true for low-income workers with a range of income sources. For example, gig workers who are paid as independent contractors spend on average 10 to 35 hours on tax return preparation annually.[69] There is a tension between what citizens want—government services to be efficient and free from fraud—and the actual relationship between the benefit and the burden.[70] Professors Pamela Herd and Donald Moynihan describe a framework for evaluating administrative burdens: "[A]dministrative burdens are the learning, psychological, and compliance costs that citizens experience in their interactions with government."[71] The interplay of the various types of costs can explain the difference in the uptake or utilization rates of various programs—from the effectively 100 percent participation rate in Social Security, to the 80 percent participation rate in the EITC, and the roughly 65 percent participation rate of the population eligible for federal food assistance.[72] The burdens are measurable: the Treasury Department estimates that 6.7 billion hours per year are spent on tax preparation and compliance,[73] while over 40 percent of Americans have returns that are sufficiently simple for the IRS to prepare them on its own—translating into 225 million hours saved.[74]

The benefits of over-withholding in this framework are multiple. Learning costs are effectively zero because withholding happens automatically. A previous learning cost—how to calculate one's proper withholdings—is removed, as the default will generate a refund for the vast majority of low- and middle-income filers. Employers have no additional learning cost, beyond what is typically required for the implementation of W-4 withholdings. Compliance costs are also reduced. As discussed above, filers facing refunds are less likely to engage in tax minimization behavior that could trigger an audit. This reduces compliance costs both for the filer and for the IRS. Further, a reduction in balances owed eliminates a portion of the compliance costs put on filers who must enter into payment plans with the IRS or state taxation agencies. As with learning costs, employers will see no change to their compliance costs—and perhaps will see a reduction in processing of W-4s as employees will not need to alter their withholdings with such frequency. Finally, psychological costs are reduced on the front-end as taxpayers have a much higher assurance of a refund at the end of each year and on the back-end from a reduction in the number of people who face a surprise tax bill due when they file their taxes.

Unlike most policy proposals suggesting a reduction on administrative burdens for citizens, this policy does not come with increased monetary costs for the government. The

[69] Kathleen DeLaney Thomas, *Taxing the Gig Economy*, 166 U. PA. L. REV. 1415, 1430 (2018).

[70] PAMELA HERD & DONALD P. MOYNIHAN, ADMINISTRATIVE BURDEN: POLICYMAKING BY OTHER MEANS 12 (2018).

[71] *Id.* at 22.

[72] *Id.* at 6.

[73] Cass Sunstein, *How to Simplify the Tax Code. Simply.*, TIME (May 31, 2013), https://ideas.time.com/2013/05/31/how-to-simplify-the-tax-code-simply [https://perma.cc/ZXC5-7URZ].

[74] AUSTAN GOOLSBEE, THE SIMPLE RETURN: REDUCING AMERICA'S TAX BURDEN THROUGH RETURN-FREE FILING 5 (2006).

IRS needs to do nothing more than amend its withholding formula and Form W-4 and is in fact likely to see increases in revenue as discussed above.

#### *3. Maximize Positive Impacts of the EITC and the CTC*

The policy purpose of the EITC is to incentivize work, providing a bonus for increased hourly wages or salaries for low-income individuals.[75] The purpose of the CTC is to provide an extra payment (or, for higher-income individuals, a reduction in tax burden) for families who take on the increased cost of child-rearing.[76] The underlying goal of both is to provide cash assistance to low-income families. These programs are negated when unnecessary tax balances are owed as a result of chronic under-withholding, eating up those cash distributions.

### B. Proposed Policy: Withhold from the First Dollar Earned

The proposed policy adopts a new default withholding rule, which begins withholding income tax from the first dollar earned and assumes a "single" filing status for all wage earners, regardless of family status or number of income sources. Instead of assuming that everyone has only a single employer, the proposed default rule assumes that many taxpayers have multiple sources of income, that those taxpayers with multiple jobs do not or are not able to correctly fill out a W-4, and that over-withholding has positive policy outcomes in the form of increased savings or reduced debt. Under the current rule, if taxpayers are earning at a rate where their annual income is subject to the standard deduction of their filing status, often no income tax is withheld by the employer. The proposed policy simply removes the tax-free threshold for all wage-earning jobs. Instead of requiring an income above the threshold to initiate income tax withholdings, the new default rule would be for employers to ignore the income tax-free threshold and start withholding from the first dollar earned, adopting the assumption that all workers are single for the purpose of calculating their withholdings.

Workers with a single income source who change jobs during the tax year will similarly benefit under the proposed policy. Currently, a worker who leaves one job and starts another faces a default of under-withholding at their second job, as the second employer does not begin withholding at the first dollar even though the employee has already earned income in that tax year. Thus, the policy of withholding from the first dollar earned would also reduce the unforeseen tax consequences of workers switching employers.

#### *1. Remove "Zero-Refund" Bias from Form Design*

A policy of over-withholding takes as a fundamental premise that a taxpayer, when the system works correctly, will get a refund. The current policy is that the system should attempt to reconcile a taxpayer's income using W-4s, and get the maximum number of dollars into the pockets of taxpayers today, rather than making them wait for their annual tax filing. The current policy ignores that taxpayers, on the whole, want to receive refunds, as demonstrated by the fact that very few households took advantage of an option that allowed filers who qualified for the EITC to access it during the year, paycheck by paycheck, instead of as a lump sum at the end of the year.[77] Additionally, calls for

---

[75] Hungerford & Thiess, *supra* note 31, at 2-3.

[76] *Id*. at 3-5.

[77] STEVE HOLT, BROOKINGS INST., PERIODIC PAYMENT OF THE EARNED INCOME TAX CREDIT REVISITED 2-3 (2015), https://www.brookings.edu/wp-content/uploads/2016/07/HoltPeriodicPaymentEITC121515.pdf [https://perma.cc/MT7M-YQSM]. The enrollment requirement of this

achieving a zero-refund return under the current system are not possible to achieve without either extensive tax compliance burdens on individuals or an IRS-based clearinghouse to monitor and adjust withholdings across multiple sources of income on a regular basis. Targeting zero under the current system entails averaging across all returns, which will necessarily push some taxpayers into owing tax at the end of the year, the least desired outcome for most taxpayers.[78]

Importantly, the failure to withhold correctly leads not only to tax owed, but potentially to a tax penalty. Filers who owe more than $1,000 to the IRS can be liable for an under-withholding penalty on top of the tax owed, even if the tax is paid in full to the IRS by the filing deadline.[79] In other words, current tax law assumes that taxpayers will pay their tax in full by the end of the calendar year and that only small adjustments to the amount owed will be necessary. The default rules should match this principle.

*2. Eliminate the Tax-Free Threshold for Income Tax Withholding Purposes*

Under the basic version of the proposed policy, the primary goal would be to eliminate most taxes owed for low-income filers and, secondarily, to provide some savings opportunity for those filers. Eliminating the tax-free threshold for withholdings is the simplest, lowest-compliance cost solution from an employer's perspective. All this would require is a simple change to withholding software to eliminate the consideration of filing status and removing the higher withholding threshold as the default rule. Further, employers will find it easier to explain withholdings in terms of the existing tax-brackets, without needing to reference other policy considerations, calculations, or formulas, as most employees will have the same withholding regime rather than the current hyper-individualized system.

Additionally, by establishing a default rule that works for most individuals, unlike our overly-customized current system, employers will reduce compliance costs in the form of reduced W-4 usage, both during on-boarding and after, when employees periodically seek to optimize their withholdings due to family or employment status changes.

*3. Examples of the Current System vs. the Proposed Policy*

The following examples illustrate the difference in outcome between the current system and the proposed policy of withholding from the first dollar. These examples examine single and head of household filers at approximately the 25th and 50th percentiles for individual annual incomes in the U.S. 2020 tax law (including tax rates, deductions, EITC, and CTC tables).

These examples demonstrate the policy's ability to prevent surprise tax bills due for single filers with multiple wage-income sources and for unmarried adults with dependents as they transition out of preferential filing status (with refundable credits) to single filing status. These examples further demonstrate that this remains true at both low- and middle-income levels.

a. Single, Low-Income Filer

Under the current system, if a single taxpayer (Taxpayer 1) is earning $1,000 per month at Company A, their projected annualized income is $12,000, below the 2020

---

program, as well as compliance issues, created an administrative burden, which may also have contributed to its low enrollment numbers. *See id.* at 4-5.

[78] Bell, *supra* note 7.

[79] IRS, *Topic No. 306*, *supra* note 18.

standard deduction threshold of $12,400. If that is their only job, this would be the correct withholding scheme. However, if Taxpayer 1 gets a second job at Company B three months into the year, also earning $1,000 a month, the taxpayer has just added $9,000 in annual income, but no income tax is withheld by default. Unless the taxpayer successfully adjusts their withholdings using a W-4 form, and their employer properly adjusts the amount withheld, this taxpayer with just $21,000 in annual income would owe $860 in federal income tax at the end of the year. Importantly, this tax balance owed is not the result of non-compliance, but simply because the current withholding scheme uses a default rule of a single employer.

Under the proposed policy, Company A would have been withholding from the first dollar and $1,243 in federal income tax would have been withheld. Company B would have withheld an additional $900. Taxpayer 1 still pays $860, but under this policy this would be more than covered by their withholdings and they would be entitled to a $1,283 refund. While the take-home pay for this taxpayer is reduced by $82 per bi-weekly pay period, the taxpayer no longer has to worry about owing an indeterminate amount of money at the end of the year and will receive the equivalent of 73 percent of a month's salary in a saved, lump-sum refund.

**Table 2: Taxpayer 1: single, low-income filer.**[80]

**Current system**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 12,000 | $ 9,000 | $ 21,000 |
| **Standard deduction applied** | $ 12,400 | $ 12,400 | $ 12,400 |
| **Apparent taxable income** | $ - | $ - | $ 8,600 |
| **Withheld at 10%** | $ - | $ - | $ 860 |
| | | | |
| | | | |
| **Total withheld** | $ - | | |
| **Total owed** | | | $ 860 |
| **Refund** | | | $ (860) |
| **% of monthly earnings received (owed)** | | | (49%) |

**Proposed policy**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 12,000 | $ 9,000 | $ 21,000 |
| **Standard deduction applied** | $ - | $ - | $ 12,400 |
| **Apparent taxable income** | $ 12,000 | $ 9,000 | $ 8,600 |
| **Withheld at 10%** | $ 988 | $ 900 | $ 860 |
| **Withheld at 12%** | $ 255 | - | |
| | | | |
| **Total withheld** | $ 2,143 | | |
| **Total owed** | | | $ 860 |
| **Refund** | | | $ 1,283 |
| **% of monthly earnings received (owed)** | | | 73% |

### b. Low-Income Filer with One Dependent, Filing as Head of Household

Taking the same earnings scenario as above, but adding an 18-year-old dependent, the withholding scenario becomes less dire for Taxpayer $1_A$. Because of a higher standard deduction of $18,650 instead of $12,400 from their head of household filing status, this taxpayer only has a federal income tax burden of $235. Even though under the current scheme their employer has not withheld any federal income tax, as it did with Taxpayer 1, Taxpayer $1_A$ will benefit from the EITC due to their dependent and will receive a refund

---

[80] Assumptions: (1) No W-4 is filed: under current policy, withholdings are calculated assuming the filer is a single person with no dependents claiming the standard deduction. Under proposed policy, withholding begins at the first dollar. (2) Only the EITC and the CTC are considered. (3) FICA taxes are not considered because they are subject to separate mandatory withholding schedules and begin at the first dollar. (4) Total earnings of $21,000 was selected for being approximately the 25th percentile of individual annual earned income in the United States.

of $2,972.[81] Under the proposed policy, Taxpayer $1_A$'s employer would withhold from the first dollar and Taxpayer $1_A$ would receive a refund of $5,115. Take-home pay for this taxpayer would have decreased by the same $82 per week as for Taxpayer 1, but the refund amount would have increased from 170 percent of a month's salary to 292 percent.

While this policy may seem unnecessary for Taxpayer $1_A$, it is designed not for this tax year, but for the one following. In the following year, Taxpayer $1_A$'s dependent ages out of dependent eligibility for the purposes of the EITC and Taxpayer $1_A$ suddenly finds themselves in the same tax situation as Taxpayer 1 in Table 2 above. Under the current system, the refund for this taxpayer would turn into an amount owed: as noted above, Taxpayer $1_A$ receives $2,972 when their dependent is 18, but owes a $860 tax the following year when that dependent turns 19. Taxpayer $1_A$'s earnings are unchanged. The simple loss of preferential filing status (head of household) and the dependent's aging out of EITC qualification effects a dramatic change in tax circumstance.

Under the proposed policy, Taxpayer $1_A$ would still see a dramatic decline in their refund—from $5,115 to $1,283—but unlike the current system, Taxpayer $1_A$ would no longer be pushed into a surprise tax bill due from one year to the next. While the taxpayer may not benefit in that year from the forced savings aspect of the policy as in prior years, the taxpayer also has not been pushed into the more problematic scenario of owing the equivalent of a half month's salary instead of receiving nearly two-month's salary as they might have expected.

[81] This amount could be higher if the dependent is under age 17 and therefore qualifies the taxpayer for the CTC too, but for this example, we will assume the dependent is age 18 and thus only makes the taxpayer eligible for the EITC.

**Table 3: Taxpayer $1_A$: low-income filer with one dependent, filing as head of household.**[82]

**Current system**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 12,000 | $ 9,000 | $ 21,000 |
| **Standard deduction applied** | $ 12,400 | $ 12,400 | $ 18,650 |
| **Apparent taxable income** | $ - | $ - | $ 2,350 |
| **Withheld at 10%** | $ - | $ - | $ 235 |
| | | | |
| **Total withheld** | | $ - | |
| **EITC applied** | | $ 3,207 | |
| **Total owed** | | | $ 235 |
| **Refund** | | | $ 2,972 |
| **% of monthly earnings received (owed)** | | | 170% |

**Proposed policy**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 12,000 | $ 9,000 | $ 21,000 |
| **Standard deduction applied** | $ - | $ - | $ 18,650 |
| **Apparent taxable income** | $ 12,000 | $ 9,000 | $ 2,350 |
| **Withheld at 10%** | $ 988 | $ 900 | $ 235 |
| **Withheld at 12%** | $ 255 | | |
| | | | |
| **Total withheld** | | $ 2,143 | |
| **EITC applied** | | $ 3,207 | |
| **Total owed** | | | $ 235 |
| **Refund** | | | $ 5,115 |
| **% of monthly earnings received (owed)** | | | 292% |

### c. Single, Medium-Income Filer

This policy has similar effects for medium-income filers as well. Taxpayer 2 has two jobs at Company A and Company B, each paying $20,000 annually, for a total annual income of $40,000. Each employer withholds assuming the single $12,400 standard

[82] Assumptions: (1) No W-4 is filed: under current policy, withholdings are calculated assuming the filer is a single person with no dependents claiming the standard deduction. Under proposed policy, withholding begins at the first dollar. (2) Only the EITC and the CTC are considered. (3) FICA taxes are not considered because they are subject to separate mandatory withholding schedules and begin at the first dollar. (4) Dependent is age 18, which qualifies the filer for the EITC, but not the CTC. (5) Total earnings of $21,000 was selected for being approximately the 25th percentile of individual annual earned income in the United States. This table can be viewed in conjunction with “Table 2. Taxpayer 1,” or separately. Viewed in conjunction, Table 3’s scenario is the last year of Taxpayer 1’s dependent’s eligibility for the EITC and Table 2 represents the following year, depicting the precipitous drop year-to-year in Taxpayer 1’s refund.

deduction, and $1,520 is withheld from Taxpayer 2's pay. However, Taxpayer 2 will owe $3,115 in taxes that year, leaving them with a balance of $1,595 due when they file their return—more than what Taxpayer 2 takes home in a single, bi-weekly pay period and 48 percent of their monthly wage.

Under the proposed policy, the employers would have started withholding from the first dollar earned, amounting to a total of $4,405. This would leave Taxpayer 2 with a refund of $1,291, or 39 percent of their monthly wage. Throughout the year, the taxpayer would have taken home $111 less per pay period, but under this proposed policy does not have to worry about saving for the surprise tax bill due.

**Table 4: Taxpayer 2: single, middle-income filer.**[83]

**Current system**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 20,000 | $ 20,000 | $ 40,000 |
| **Standard deduction applied** | $ 12,400 | $ 12,400 | $ 12,400 |
| **Apparent taxable income** | $ 7,600 | $ 7,600 | $ 27,600 |
| **Withheld at 10%** | $ 760 | $ 760 | $ 988 |
| **Withheld at 12%** | | | $ 2,127 |
| | | | |
| **Total withheld** | | $ 1,520 | |
| **Total owed** | | | $ 3,115 |
| **Refund** | | | $ (1,595) |
| **% of monthly earnings received (owed)** | | | (48%) |

**Proposed policy**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 20,000 | $ 20,000 | $ 40,000 |
| **Standard deduction applied** | $ - | $ - | $ 12,400 |
| **Apparent taxable income** | $ 20,000 | $ 20,000 | $ 27,600 |
| **Withheld at 10%** | $ 988 | $ 988 | $ 988 |
| **Withheld at 12%** | $ 1,215 | $ 1,215 | $ 2,127 |
| | | | |
| **Total withheld** | | $ 4,405 | |
| **Total owed** | | | $ 3,115 |
| **Refund** | | | $ 1,291 |
| **% of monthly earnings received (owed)** | | | 39% |

d. Medium-Income Filer with Two Dependents, Filing as Head of Household

Table 5 takes the same earnings scenario as above, but assumes that the taxpayer has two dependents, ages 16 and 18, and files as head of household. As with Taxpayer $1_A$, for filers receiving large refundable credits through the EITC or CTC, the proposed policy simply adds to the refund this filer would already be receiving. Taxpayer $2_A$ has a total income tax bill of $2,365, lower than Taxpayer 2's due to Taxpayer $2_A$'s higher standard deduction. In addition, Taxpayer $2_A$ is receiving the EITC calculated with two eligible

[83] Assumptions: (1) No W-4 is filed: under current policy, withholdings are calculated assuming the filer is a single person with no dependents claiming the standard deduction. Under proposed policy, withholding begins at the first dollar. (2) Only the EITC and the CTC are considered. (3) FICA taxes are not considered because they are subject to separate mandatory withholding schedules and begin at the first dollar. (4) Total earnings of $40,000 was selected for being approximately the 50th percentile of individual annual earned income in the United States.

dependents, and the CTC for one eligible dependent. Taxpayer $2_A$ will therefore receive a refund of $2,562 under the current system, or 77 percent of their monthly gross income. Under the proposed policy, with income tax withheld from the first dollar, Taxpayer $2_A$ will receive a refund of $5,447, or 163 percent of their monthly gross income, while seeing a reduction in take-home pay of $111 per bi-weekly pay period.

The benefits of the proposed policy come to light in subsequent years. The above scenario describes Year 0, and the following describes Year 1, when the older dependent has aged out of EITC eligibility, and the younger dependent aged out of CTC eligibility but maintains EITC eligibility. Under the current system, due to the loss of over $3,000 in refundable credits, Taxpayer $2_A$ will owe $674 in Year 1, compared to a refund of $2,562 the year prior. Under the proposed policy, the taxpayer will still see a drop in their refund, from $5,447 to $2,212—but they will still be receiving the equivalent of 66 percent of monthly gross income as a refund instead of finding to their surprise that they owe the equivalent of 20 percent of their monthly gross income at the end of the year.

In this scenario, in Year 2, Taxpayer $2_A$ becomes Taxpayer 2. Under the current system, Taxpayer 2 and Taxpayer $2_A$ would have had a three-year refund trajectory of $2,562 to -$674 to -$860, whereas under the proposed policy that same taxpayer's refund trajectory would have been $5,447 to $2,212 to $1,291.

**Table 5: Taxpayer $2_A$: middle-income filer with two dependents, filing as head of household, at year zero.**[84]

**Current system: Year 0**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 20,000 | $ 20,000 | $ 40,000 |
| **Standard deduction applied** | $ 12,400 | $ 12,400 | $ 18,650 |
| **Apparent taxable income** | $ 7,600 | $ 7,600 | $ 21,350 |
| **Withheld at 10%** | $ 760 | $ 760 | $ 988 |
| **Withheld at 12%** | | | $ 1,377 |
| | | | |
| **Total withheld** | | $ 1,520 | |
| **EITC applied** | | $ 1,406 | |
| **CTC applied** | | $ 2,000 | |
| **Total owed** | | | $ 2,365 |
| **Refund** | | | $ 2,562 |
| **% of monthly earnings received (owed)** | | | 77% |

**Proposed policy: Year 0**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 20,000 | $ 20,000 | $ 40,000 |
| **Standard deduction applied** | $ - | $ - | $ 18,650 |
| **Apparent taxable income** | $ 20,000 | $ 20,000 | $ 21,350 |
| **Withheld at 10%** | $ 988 | $ 988 | $ 988 |
| **Withheld at 12%** | $ 1,215 | $ 1,215 | $ 1,377 |
| | | | |
| **Total withheld** | | $ 4,405 | |
| **EITC applied** | | $ 1,406 | |
| **CTC applied** | | $ 2,000 | |
| **Total owed** | | | $ 2,365 |
| **Refund** | | | $ 5,447 |
| **% of monthly earnings received (owed)** | | | 163% |

[84] Assumptions: (1) No W-4 is filed: under current policy, withholdings are calculated assuming the filer is a single person with no dependents claiming the standard deduction. Under proposed policy, withholding begins at the first dollar. (2) Only the EITC and the CTC are considered. (3) FICA taxes are not considered because they are subject to separate mandatory withholding schedules and begin at the first dollar. (4) Dependents are age 16 and 18: the former qualifies as a dependent for both EITC and CTC, the latter qualifies as a dependent for EITC purposes only.

**Table 6: Taxpayer $2_A$: middle-income filer with two dependents, filing as head of household, at year one.**[85]

**Current system: Year 1**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 20,000 | $ 20,000 | $ 40,000 |
| **Standard deduction applied** | $ 12,400 | $ 12,400 | $ 18,650 |
| **Apparent taxable income** | $ 7,600 | $ 7,600 | $ 21,350 |
| **Withheld at 10%** | $ 760 | $ 760 | $ 988 |
| **Withheld at 12%** | | | $ 1,377 |
| | | | |
| **Total withheld** | | $ 1,520 | |
| **EITC applied** | | $ 171 | |
| **CTC applied** | | $ - | |
| **Total owed** | | | $ 2,365 |
| **Refund** | | | $ (674) |
| **% of monthly earnings received (owed)** | | | (20%) |

**Proposed policy: Year 1**

| | Company A | Company B | Total income, actual tax owed |
|---|---|---|---|
| **Salary** | $ 20,000 | $ 20,000 | $ 40,000 |
| **Standard deduction applied** | $ - | $ - | $ 18,650 |
| **Apparent taxable income** | $ 20,000 | $ 20,000 | $ 21,350 |
| **Withheld at 10%** | $ 988 | $ 988 | $ 988 |
| **Withheld at 12%** | $ 1,215 | $ 1,215 | $ 1,377 |
| | | | |
| **Total withheld** | | $ 4,405 | |
| **EITC applied** | | $ 171 | |
| **CTC applied** | | $ - | |
| **Total owed** | | | $ 2,365 |
| **Refund** | | | $ 2,212 |
| **% of monthly earnings received (owed)** | | | 66% |

[85] Assumptions: (1) No W-4 is filed: under current policy, withholdings are calculated assuming the filer is a single person with no dependents claiming the standard deduction. Under proposed policy, withholding begins at the first dollar. (2) Only the EITC and the CTC are considered. (3) FICA taxes are not considered because they are subject to separate mandatory withholding schedules and begin at the first dollar. (4) Dependent is age 17, qualifying as a dependent for EITC purposes only. The second dependent from the prior year has aged out of dependent eligibility for this taxpayer. This table can be viewed in conjunction with Taxpayer 2 from Table 4. The scenario in that table would be Year 3 for Taxpayer $2_A$'s scenario.

#### 4. *Taxpayers Who Wish to Adjust Their Withholdings Can Avail Themselves of the W-4*

Finally, this proposed policy does not forgo the benefits available to taxpayers under the current system: the option to customize withholdings through the W-4 would remain in place. Filers who wish to calibrate their withholdings to actual earnings would retain that optionality, just as they do today. The benefit of this policy is that it adjusts the default to provide for a forced saving mechanism by having an opt-out, rather than an opt-in, policy for savings. In so doing, a large number of low- and middle-income participants will, by default, save a certain portion of their income passively, such that it increases both the number of workers engaging in saving and the amounts they save. The benefit of such a system has been evidenced in the retirement savings context.[86] Indeed, the purpose of this proposed policy is to change the default to one where fewer people owe tax balances at the end of the year and explicitly uses the power of W-4 defaults to do so. By eliminating the need for most employees to fill out and properly maintain W-4s at all moments that could impact their tax burden (point of hire, acquisition of a new job or income source, change in filing status), the proposed policy eliminates errors that could lead to those balances. For high tax-knowledge taxpayers—or those with accountants—the ability to change the default exists, just as it does in managing a retirement portfolio.

### C. A More Radical Alternative, "Over-Withholding Plus": Withholding to Force Savings

While the policy proposal stated above prioritizes eliminating surprise tax bills due, an "over-withholding plus" policy would prioritize turning tax withholdings into a deliberate vehicle for savings. This proposed policy would be layered on top of the basic over-withholding policy. Rather than simply aligning withholdings exactly with tax brackets, an additional percentage would be withheld with the goal of generating a savings component to a tax refund.

**Table 7: "Over-withholding Plus" withholding rates**

| **Tax Rate** | **Tax Rate with Savings %** | **Taxable Income (Single)** | **Max withheld under basic withholding** | **Additional savings under over-withholding plus** |
|---|---|---|---|---|
| **10%** | 15% | Up to $9,875 | $988 | $494 |
| **12%** | 17% | $9,876 to $40,125 | $4,618 | $2,007 |
| **22%** | 27% | $40,126 to $85,525 | $14,606 | $4,277 |

This proposed policy should be deployed as an opt-out system. Under an opt-out system, a box would be added to the W-4 and filers would need to check the box to not have income subject to this additional withholdings. If this were instead deployed as an opt-in system, a similar box could be added to the W-4, where taxpayers would be required to check the box in order to opt-in to participation in the savings program. Given that opt-out systems are drastically more effective at encouraging participation in many realms,

[86] Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. ECON. 1149, 1150 (2001).

including financial savings, the opt-out mechanism would be preferable to fulfill the policy goal of promoting saving.[87]

This savings program would be limited to the first three tax brackets for several reasons. The goal is to increase savings for low- and middle-income filers, all of whom are encompassed by the income limits of the first three brackets. Higher income filers are much more likely to have access to traditional savings opportunities in the form of consumer banking accounts, investment accounts, and retirement accounts.[88] Additionally, the purpose of this program is to address a specific lack of savings among an income-based demographic, not to turn tax withholdings into the primary savings option for all tax filers.

Withholdings under this scheme, and even under the first-dollar withholding policy, will reduce take-home earnings for low-income families. However, there are already indications from existing tax policy that taxpayers would prefer deferred gains rather than accessing refunds earlier if it means a reduced risk of owing tax at the end of the year.[89] Historically, when the IRS made advanced payments possible under the EITC and CTC, less than 1 percent of taxpayers availed themselves of the opportunity to access funds throughout the year, instead of in one lump-sum payment.[90] While knowledge of these programs may have been limited, when presented with the option, taxpayers are extremely wary of options that, if their income changes, may result in balances owed at the end of the year.[91]

### D. Objections

There are three major objections to the policy proposed here. First, over-withholding is an interest-free loan to the government that deprives workers of money as it is earned and depresses economic activity; second, that taxpayers prefer higher take-home pay, which allows for taxpayers to have access to income earned as financial shocks arise during the year, as opposed to higher annual tax refunds; and third, the current W-4 provides maximal flexibility for tax planning. A fourth objection, political in nature, not dealt with in full here, was most forcefully articulated by then-Governor Ronald Reagan when he opposed state income tax withholdings in California: "taxes should hurt."[92] This Note takes as a foundational premise that minimizing tax-related "hurt" is efficient for individuals and governmental bodies and does not deal with the political implications of these policy proposals.

The most common objection to tax withholdings is that it amounts to a voluntary overpayment, functioning as an interest-free loan to the U.S. government.[93] Critics argue that a lack of access to funds during the year may increase debt throughout the year, and

---

[87] JOHN BESHEARS, *ET AL.*, *The Importance of Default Options for Retirement Saving Outcomes: Evidence from the United States*, *in* SOCIAL SECURITY POLICY IN A CHANGING ENVIRONMENT 167, 170-75 (Jeffrey Brown, et al., eds., 2009).

[88] *See id.*

[89] *See* Janet Holtzblatt, *Trade-Offs Between Targeting and Simplicity: Lessons from the U.S. and British Experiences with Refundable Tax Credits*, in THE CHALLENGES OF TAX REFORM IN A GLOBAL ECONOMY 39, 49 (James Alm, *et al.*, eds., 2006).

[90] *Id.* at 48 (describing the use of the EITC advanced payment mechanism in 2002).

[91] *Id.* at 49.

[92] Lou Cannon, *The Leader He Was, the Leader He Wasn't*, WASH. POST (Apr. 26, 1980).

[93] Darla Mercado, *Here's Why You Shouldn't Celebrate That Big Tax Refund*, CNBC (Mar. 7, 2020), https://www.cnbc.com/2020/03/06/heres-why-you-shouldnt-celebrate-that-big-tax-refund.html [perma.cc/7H3B-6Y6A]; Maurie Backman, *Americans Are Very Dependent on Tax Refunds This Year -- and That's a Problem*, MOTLEY FOOL (Jan. 16, 2020), https://www.fool.com/taxes/2020/01/16/americans-are-very-dependent-on-tax-refunds-this-y.aspx [perma.cc/4Q4E-3636].

that because taxpayers tend not to use their refunds for consumer spending, over-withholding depresses economic activity.[94] They also argue that money now is better than money later and all taxpayers should behave accordingly.[95]

However, this objection is in tension with itself and with the notion that low-income filers prefer higher take-home pay to a higher refund. Interest rates for a typical savings account are, at the time of this writing, around 0.04 percent,[96] and the FDIC considers 19 percent of Americans underbanked.[97] Not only do many Americans lack access to traditional savings opportunities, those who do have access are not seeing notable yields—the current average interest rate on savings accounts only translates to $0.40 earned over the course of a year on a $1,000 balance. Access to funds throughout the year, touted as a benefit, makes it even less likely for savings to actually accrue—there is a reason why those in higher income brackets use long-term mandatory savings options like 401(k)s, health savings plans, and 529s.[98] Debt that accrues will never be paid without savings, and the objection that money now is better than money later, which would tend to increase consumer spending, is in natural tension with a desire to increase consumer savings. This distillation of the time-value of money belies the general problem that low-income individuals face when confronted with the real-life implications of fiscal policy—there are contradictory messages of incentivizing present consumer spending while demonizing lack of consumer savings.

The timing of these annual disbursements, as opposed to receiving smaller amounts every other week as part of a paycheck, is objected to on the basis that taxpayers may accrue debt as a result of not having access to cash when it is earned. Families that undergo financial upheaval after that year's refund has been spent will not have access to their tax withholdings until the next year. Only a small portion of financial shocks that families experience will conveniently coincide with the arrival of tax refunds that can help them weather it.[99] However, the purpose of forced savings in this context is to help avoid an additional financial shock in the form of tax owed and to increase the accessibility of savings to a broader group of low-income taxpayers in an environment where other savings options are not available. Individuals tend to overweight their current financial needs and underweight their future needs.[100] Forced savings compensates for this myopia which leads taxpayers to expend income currently rather than saving for the future. Additionally, optimizing savings can be a daunting process, the complexity of which is compounded for

[94] Taylor Telford, *How Much Do Americans Depend on Their Tax Refunds? Quite a Lot, It Turns Out*, WASH. POST (Mar. 5, 2019), https://www.washingtonpost.com/business/2019/03/05/how-much-do-americans-depend-their-tax-refunds-quite-lot-it-turns-out/ [perma.cc/F55M-J2SS].

[95] *See* Heritage Explains, *What You Need to Know About Your Tax Refund This Year*, HERITAGE FOUND., at 10:40 (Apr. 11, 2019), https://www.heritage.org/taxes/heritage-explains/what-you-need-know-about-your-tax-refund-year [perma.cc/U9JJ-5FUQ] (arguing against over-withholding).

[96] Lauren Perez, *What Is the Average Interest Rate for Savings Accounts?*, SMARTASSET (Feb. 25, 2021), https://smartasset.com/checking-account/average-savings-account-interest [https://perma.cc/5VWS-XHEY].

[97] Ken Sweet, *Americans Who Don't Have a Bank Account at Lowest Level Ever*, AP NEWS (Oct. 23. 2018), https://apnews.com/8b2b93d4e9474c418853e0f20e79aaa8 [perma.cc/AG4W-97X4].

[98] *See* Linda Stern, *Buy a House, and Other Forced Savings*, REUTERS (Feb. 22, 2012), https://www.reuters.com/article/us-column-personal-finance/buy-a-house-and-other-forced-savings-idUSTRE81L1X320120222 [https://perma.cc/B23E-HCZD] (describing various options for forced savings).

[99] Sternberg Greene, *supra* note 4, at 547.

[100] Louis Kaplow, *Government Policy and Labor Supply with Myopic or Targeted Savings Decisions*, 29 TAX POL'Y & ECON. 159, 160 (2015).

families with unstable income streams.[101] The proposed policy of forced savings both helps push back against that myopia and reduces the planning needs for low-income households to engage in savings. Unlike retirement funds, the forced savings become available annually; therefore, the bi-weekly income tradeoff, while real, is still predictably accessible to savers. This proposed policy is not meant to cure all the difficulties of savings for low-income families. It is simply meant to introduce a way to reduce large, predictable financial hardships, in the form of surprise tax bills due, while recognizing explicitly that tax refunds are already being used as a savings tool and making that function of the tool more deliberate.

Finally, defenders of the new Form W-4 say that it provides maximal flexibility and addresses a wide range of withholding issues.[102] This objection misses the point of this policy proposal. The current policy provides for a default withholding that directs employers to withhold as if the filer is single, takes the standard deduction, and has no other income.[103] This proposal asks only for a change in the default, to minimize the number of people who need to utilize the Form W-4 at all. Filers who wish to engage in tax planning—be it to increase or decrease their withholdings—may continue to do so.

## III. EPILOGUE: TAX WITHHOLDINGS IN A TIME OF PANDEMIC

The underlying premise of the W-4 withholding scheme is foreknowledge of future earnings. Over 57 million new unemployment claims were filed in the first six months of the COVID-19 pandemic,[104] illustrating the enormous uncertainty that taxpayers faced as they filed their 2019 taxes in the early months of the pandemic. This also demonstrates the uncertainty filers faced in attempting to tax plan for 2020 as job availability and stability was upended. Filing taxes for many in mid-2020 meant economic relief in the form of their refund. But for those whose withholdings were inaccurate for the variety of reasons discussed in this Note, the three-month deferral of Tax Day to July 15, 2020 only delayed the inevitable tax bill that Americans were less able to pay than ever due to the collapsing employment and earnings environment. For some, the Economic Impact Payments[105] deposited into accounts were soon returned to the IRS as payment for unexpected taxes owed. For others, a tax bill that might have seemed manageable a year ago might have been insurmountable due to job loss, and filers forced to choose between basic necessities and paying taxes that were not withheld from their pay.

Under the policy proposed in this Note, the scale would be tipped far in the other direction. Almost every American earning less than $75,000—the threshold for receiving the full relief check—would have received a refund right at the time they need it most. By creating an automatic savings mechanism in the form of tax withholdings, the IRS could help create a small, zero-cost relief fund for all low- and middle-income Americans.

---

[101] *See id*. at 160-61.

[102] *See* Sally P. Schreiber, *IRS Proposes Rules to Update Income Tax Withholding, Revises Form W-4*, J. ACCT. (Feb. 12, 2020), https://www.journalofaccountancy.com/news/2020/feb/irs-rules-income-tax-withholding-form-w-4-22959.html [perma.cc/XEW2-JY8E].

[103] *See* Press Release, *IRS, Treasury Issue Proposed Regulations Updating Income Tax Withholding Rules*, IRS (Feb. 11, 2020), https://www.irs.gov/newsroom/irs-treasury-issue-proposed-regulations-updating-income-tax-withholding-rules [perma.cc/K2ZY-F5CV].

[104] Jack Kelly, *Jobless Claims: 57.4 Million Americans Have Sought Unemployment Benefits Since Mid-March—Over 1 Million People Filed Last Week*, FORBES (Aug. 20, 2020), https://www.forbes.com/sites/jackkelly/2020/08/20/jobless-claims-574-million-americans-have-sought-unemployment-benefits-since-mid-marchover-1-million-people-filed-last-week/?sh=58da4a7a6d59 [https://perma.cc/4RCU-7RTY].

[105] *Recovery Rebate Credits and Economic Impact Payments*, IRS (Feb. 17, 2021), https://www.irs.gov/coronavirus/economic-impact-payments [perma.cc/BMZ2-P8PU].

Furthermore, as tens of millions of Americans navigated fluctuating employment statuses, under this policy workers who took on multiple jobs would not have had to navigate complex tax planning or worry about under-withholding, leading to large future tax bills. Perhaps most importantly, the IRS would not be in the position of pushing Americans further into debt just as they are least able to pay new tax obligations.