



There's No Such Thing as a Free Tax Holiday

A few weeks ago, President Donald Trump proposed a payroll tax holiday to Americans earning less than \$100,000 per year. The gesture is better described as a deferral of the payroll tax burden until April 2021, and that has some people worried. They should be.

Talking about his plan, the president explained, "In a few moments, I will sign a directive, instructing the Treasury Department to allow employers to defer payment of the employee portion of certain payroll taxes from Sept. 1." The deferral will last until the end of 2021. As the president added, "This will mean bigger paychecks for working families."

An actual payroll tax holiday does mean an increase in take-home wages for some. According to recently published Internal Revenue Service guidance on the president's order, employers can temporarily stop withholding the employee's 6.2% share of Social Security taxes for workers earning under \$104,000 per year. That means more money in their paychecks for those eligible workers.

This could be significant. A little-known fact is that, for a majority of American taxpayers, the largest share of their federal tax bill is the payroll tax, not the income tax. In the way it's designed, the payroll tax is regressive, so it hits lower-income earners harder. But a temporary reprieve is pretty much where the good news ends for the employees.

For one thing, as noted, the benefit may be short-lived. According to the IRS, unless Congress decides to go ahead and forgive the tax, it will eventually need to be collected by employers and sent to Uncle Sam. This is guaranteed to become a massive headache for employers, who will ultimately have to collect the deferred taxes from their employees. As a result, some large companies such as United Parcel Service have already announced that they will continue to collect the payroll tax from their employees and send the money to the federal government as usual.

Second, Congress could go ahead and decide to forgive the tax as part of a future coronavirus-relief package. However, short of any other adjustments, that's a bad idea. For instance, no matter how some may try to present the move, it won't stimulate the economy. Data from the Congressional Budget Office show that tax cuts geared to lower- and middle-income earners return one-third in economic growth of what they cost in lost revenue.



Written by [Veronique de Rugy](#) on September 3, 2020

That leads me to my third issue with the policy. I am all in favor of letting taxpayers keep more of their money than they used to. I like my government bill as small as it can be. But that's only if you offset the reduction in tax revenue with a reduction in spending in general, or Social Security benefits in particular. You see, the portion of the payroll tax that would be cut is collected to fund spending on Social Security benefits for current retirees. It's also part of the process for current employees to become eligible for Social Security benefits in the future.

I understand that people don't like to pay the payroll tax. But it should go without saying that if you stop paying the tax that funds the Social Security system, you should pair it with an equivalent reduction in benefits. If that doesn't happen, then the benefits for Social Security will have to come from the general funds, which is what happened during past payroll tax holidays. That means that the federal government will have to borrow the money and expect future generations to pay the bill plus interest.

Unfortunately, politicians are so shortsighted that this is probably where we're heading. Think about it this way: If Democrats perceive (as they likely do) that this move by the president is just meant to buy some votes in November, they will oppose any attempt to pass legislation that forgives the tax. However, as some point out, those tax deferrals will eventually become due, and employers may then have to withhold twice the amount of payroll taxes from employees' paychecks starting in January.

This will create quite a bit of pressure on Congress to waive the deferred taxes next year. But even if that happens, somebody somewhere at some point will have to pay. There's no such thing as a free tax holiday.

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