Opinion

Here's how Congress can raise billions — without raising taxes

The government has completely overlooked this source of revenue.

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Republicans are looking everywhere for ways to raise more revenue short of raising taxes. This magic trick is not easily accomplished. Taxpayers, even those embracing the MAGA mindset, are not holding out their wallets and, in a burst of civic patriotism, pleading with the government to take their money.

However, hiding in plain view is a revenue source the government has completely overlooked.

Millions of taxpayers go through the drudgery of making quarterly estimated tax payments. Congress, however, could obviate a large part of this process — and raise billions of dollars — by instituting tax withholding on passive income (e.g., interest, dividends, royalties and retirement savings withdrawals). And here's a key component of this initiative: Those who do not want to participate could opt out.

How could a voluntary tax withholding on passive income raise such vast amounts of wealth? IRS statistics repeatedly demonstrate that when tax information reporting is coupled with withholding (think Form W-2s and salary tax withholding), the taxpayer compliance rate is approximately 99 percent. By contrast, when there is only tax information reporting (think Form 1099s pertaining to interest, dividends, and the like) but without withholding, the taxpayer compliance rate falls to 94 percent.

Here's where we connect the dots. Suppose the existing tax information returns regarding investments were to include withholding. In that case, there's compelling data that the compliance rate would correspondingly increase to 99 percent, and the government would collect nearly $20 billion more in tax revenue annually. Over the typical 10-year period during which Congress measures revenue receipts, this would amount to roughly $200 billion — without raising tax rates.

Tax withholding on passive income is not a new or novel idea. Decades ago, Congress mandated the institution of tax withholding on interest and dividends. However, banking institutions and brokerage firms balked, finding this requirement an administrative nightmare and resulting in its subsequent repeal.

Fast forward to today, when gigabytes of data can be processed in nanoseconds, alleviating administrative burdens that banking institutions and brokerage firms once endured. Today's banks and brokerage firms already withhold without a hitch on passive income from nonresident alien investors. And withholding on passive income is a commonplace phenomenon worldwide — for example, in Japan and in Britain, as well as countries far less industrialized than the United States, such as Nicaragua.

The proposal itself is straightforward. If Congress passed a bill instituting this change, at the beginning of next year, banking institutions and brokerage firms would be responsible for withholding at a rate of 15 percent on passive income earned, remitting such sums to the Treasury and then reporting to the IRS the withheld amounts on the tax information returns they issue (e.g., Form 1099s). If taxpayers chose not to participate in this withholding regime, they could opt out, returning to making quarterly estimated tax payments.

From a political perspective, this proposal should garner overwhelming bipartisan support. Tax compliance is not a political issue, and members of both parties seek to have taxpayers fulfill their civic duties. And for politicians who dislike tax withholding because they believe it hides the true tax burden, the proposed system is voluntary.

No current tax reform proposals enhance tax compliance, reduce taxpayer and IRS administrative burdens, and generate increased revenue, all at once. Voluntary tax withholding on passive income, however, checks all these boxes. There is no reason a Congress anxious to cut taxes in other areas while keeping the deficit in check shouldn't jump at the opportunity to institute this proposed reform.

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