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Recommended Citation

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Exploiting the Salience Bias in Designing Taxes

Deborah H. Schenk*

In making decisions, individuals rely on certain heuristics or cognitive biases. One of these is salience, which generally refers to visibility or prominence. Individuals are likely to focus on items or information that are prominent or salient and ignore those that are less visible. This paper develops an argument for exploiting this cognitive bias in designing or changing taxes. Most commentary assumes that the intentional use of low-salience taxes by the government is undesirable and that increased salience is always required; to do otherwise is to take advantage of the cognitive bias that causes individuals to ignore taxes that are not prominent or salient. Although increasing salience is often desirable, there is a political economy argument for intentionally exploiting this bias by incorporating low-salience provisions into tax design. In developing the argument that utilizing this bias may be an appropriate fiscal tool, the paper begins by setting out the differences between transparency, complexity, and salience, which are often confused in the literature. The paper then makes a normative case that it is appropriate for legislators to design a tax by intentionally exploiting the cognitive bias that causes individuals to ignore information that is not prominent. The paper differs in two ways from past literature discussing salience. First it considers salience with respect to federal income taxes. Most commentators have explored salience in connection with consumption or commodity taxes. Second it considers the salience of discrete provisions, rather than merely the salience of the tax itself. It concludes with a case study where the use of low-salience tax provisions are justified and effective, i.e. where Congress finds it necessary to minimize the prominence of the tax because politically it cannot increase marginal tax rates.

I. Introduction

In making decisions, individuals rely on certain heuristics or cognitive biases. One of these is salience, which generally refers to visibility or prominence. Individuals systematically focus on items or information that is prominent or salient and ignore items or information that is less visible. This paper develops an argument for exploiting this cognitive bias in designing or changing taxes.

Public finance and tax scholars have recently begun to consider the effects of low-salience taxes. Some empirical work has focused on behavioral responses to low-salience taxes. Other work has been done to untangle the cognitive biases that result in less attention being paid to low-salience taxes. Most of the normative argument with respect to such taxes assumes that

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increased salience is preferred and that the intentional use of low-salience taxes by the government is undesirable. This distaste is manifested in the term often used to describe such taxes: “hidden taxes.”

Much of the criticism of so-called hidden taxes is misdirected. It usually is lobbed in the guise of “transparency” and “complexity,” terms that are often confused in the literature with saliency. In developing the argument that salience may be an appropriate fiscal tool, it is useful to distinguish these concepts. Thus, the paper begins by setting out the differences between transparency, complexity, and salience. In brief, I use the term “transparency” to refer to a particular characteristic of the process by which legislation is enacted. Although transparency may refer to other things, I confine its meaning in my argument to transparency of governance. Complexity likewise has been used to characterize numerous aspects of the tax system; I focus here on the use of the term to convey the degree to which a statutory provision (or regulation) is understandable. Salience refers to the visibility or prominence of a tax or provision.

The paper’s argument for the use of salience differs significantly from past literature with respect to salience and taxes. First it considers salience with respect to federal income taxes. Most commentators have explored the salience of consumption or commodity taxes. Furthermore it considers the salience of discrete provisions, rather than only the salience of the tax itself. Although an income tax is an example of a highly salient tax, there are aspects of that tax that need not be salient. Second, almost all commentators assume that a low-salience tax (or hidden tax) is not desirable. The paper makes a normative case that is appropriate for legislators to design a tax by intentionally exploiting the cognitive bias that causes individuals to ignore information that is not prominent. It makes a political economy argument that relying on salience an acceptable fiscal tool. By contrast using a low-salience provision for tax incentives or Pigouvian taxes is inappropriate because they are intended to affect behavior and thus must be prominent. The paper also considers the criticisms that might be levied against Congress for manipulating salience in adopting a tax provision. I conclude that none justifies a complete rejection of salience as a fiscal tool but that they are a caution against extensively taking advantage of cognitive biases. Finally, the paper offers a case study for using low-salience provisions. Under the current political landscape where there is a looming fiscal crisis but tax aversion and the politics of taxation make raising additional revenue extremely difficult, Congress would be well-advised to use low-salience provisions that make taxation palatable.

It seems beyond question that when citizens contemplate taxes, there are cognitive biases at work—salience is clearly one of them. While we do not know all that we need to know about such biases, it is useful to begin to think about whether it is appropriate for legislators to exploit these biases. It is too early to develop a complete theory of whether this is appropriate, but we can begin to explore when it might be.

II. Disentangling Transparency, Complexity, and Salience

The literature is replete with both arguments for transparency in the tax system and complaints about the lack of transparency.¹ These calls for transparency take several forms but all share one

¹ See, e.g., Francis Fukuyama, *State-Building: Governance and World Order in the 21st Century* 9-10 (2004) (“Strength [of institutions] includes . . . a high level of transparency and accountability in government institutions . . .

trait: Transparency is almost always assumed to be a good thing and a lack of transparency is usually taken to be a bad thing.² Some commentators refer to transparency as requiring that information be available to the public.³ That may be revealing information held by the government or it may be the government, in enacting regulation, requiring private information to be made public through disclosure. Others complain about a lack of transparency when Congress adopts a tax provision without hearings or debate or entertains the proposals of lobbyists behind closed doors. Still others complain that legislation is not transparent because it is difficult to understand, because the taxpayer cannot figure out the effects of a provision,⁴ or that it is impossible to determine from the face of the statute who benefits from tax provisions or transition rules.⁵ This last meaning often overlaps complexity in that the complaint is that the law is difficult to understand.⁶ Commentators also object to a lack of transparency when congressional rhetoric about taxes does not match the reality—for example, legislators claim that the maximum marginal tax rate has not changed, when so-called phase-outs and rate bubbles have raised the rate significantly for some taxpayers. Still others object to “hidden taxes” because they are not transparent—meaning they are not visible or prominent.⁷

. . .”); Mark Fenster, *The Opacity of Transparency*, 91 *Iowa L. Rev.* 885, 888 (2006) (transparency “is clearly among the pantheon of great political virtues”); Gia B. Lee, *Persuasion, Transparency, and Government Speech*, 56 *Hastings L.J.* 983 (2005) (elevating transparency to the level of a “principle” and arguing that the lack of transparency in government communications can have significant implications for public debate).

² See, e.g., William G. Gale & Peter R. Orszag, *An Economic Assessment of Tax Policy in the Bush Administration, 2001-2004*, 45 *B.C. L. Rev.* 1157, 1165 (2004) (“...the expansion of the AMT will raise complexity, and reduce efficiency, equity and transparency in the tax system”).

³ See, e.g. Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Process*, 43 *B.C. L. Rev.* 863, 903 (2002) (“transparency surely requires that information be available to the government”); Susanne Lohman & Deborah M. Weiss, *Hidden Taxes and Representative Government: The Political Economy of the Ramsey Rule*, 30 *Pub. Fin. Rev.* 579, 608 (2002); (discussing transparency of the tax system in terms of information asymmetry as part of a larger discussion of “hidden taxes”).

⁴ The ABA Tax Section, for example, defines transparent “to describe tax laws that apply in a straightforward and predictable way.” Their test of transparency is “whether a taxpayer can easily estimate the tax effect of an increase in his or her income.” ABA Section of Tax’n, *Statement of Policy Favoring Tax Simplicity, Stability, and Transparency*. Their examples of provisions that violate this test include the alternative minimum tax and the PEP and Pease phase outs.

⁵ See, e.g., General Accounting Office, *Budget Process: Evolution and Challenges* 12 (1996) (GAOT-AIMD-96-129) (“Transparency is important because the budget debate is critically important—not because of the numbers in it but because it represents a statement about collective priorities and collective action. In a democracy, the debate about these priorities should be made as understandable as possible.”); Block, note 3, at 903 (information about the budget process should be “offered in a *simple format*”).

⁶ See, e.g., Tara Vishwanath & Daniel Kaufmann, *Towards Transparency in Finance and Governance*, working paper at SSRN at 12 (3) (treating difficult to understand or vaguely specified tax laws as a form of lack of transparency).

⁷ Charles McLure, for example, asserts under the heading of transparency, that “taxation should not be imposed in ways that obscure its burden.” Charles E. McLure, Jr., “Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?”, 2000 *B.Y.U. L. Rev.* 77. See also Christopher C. Fennell & Lee Anne Fennell, *Fear and Greed in Tax Policy: A Qualitative Research Agenda*, 13 *Wash. U. J.L. & Pol’y* 75, 129-33 (2003) (exploring the possibility of “transparent taxpaying” by which they mean making both federal spending and

Although these objections may all be made in the name of “transparency,” they are targeting different things. The first step in the argument for the use of salience as a fiscal policy tool is to develop a taxonomy of terms that distinguishes transparency, complexity, and salience. These concepts are often confused--particularly in the tax literature--and it is important to disentangle them. This part lays out a lexicon of “transparency” that should be helpful in developing the use of salience. The paper later returns to the inter-relation of these concepts.

A. Transparency

For purposes of my argument, the term “transparency” is reserved for transparency in the political process.⁸ This substantially overlaps transparency in governance although the latter term is often used in a much broader way than intended here. Transparency in governance is almost universally viewed as a political virtue, a distinguishing characteristic of democracy. In recent decades it has emerged as a core aspect of governance.⁹ Despite its position as a principal political norm, there is, however, no accepted definition of what transparency requires or from what it derives. Relying on its dictionary meaning, almost every conception relies on “openness” in government in the sense of being open to view, particularly with respect to the sharing of information. Generally claims with respect to transparency fall into two classes. The first is that a transparent or open government is foundational in a liberal democracy.¹⁰ Under this view, the availability of laws and regulations, as well as the openness of actions of the government are required in a democracy.¹¹ Individuals must be informed to consent to be governed.

the contributions of other taxpayers more visible, which might result in “improved political efficacy of the citizenry”); Elizabeth Garrett, *Accountability and Restraint, The Federal Budget Process and the Line Item Veto Act*, 20 *Cardozo L. Rev.* 871, 924 (1999) (“[T]ransparency is particularly important because individual decisions can be lost in the midst of detailed and obscurely worded omnibus bills. In the absence of visibility, accountability is virtually impossible.”); Stefano DellaVigna, *Psychology and Economics: Evidence from the Field*, 47 *J. Econ. Lit.* 315, 350 (2009) (referring to low-salience taxes as “nontransparent taxes”); Edward J. McCaffery & Jonathan Baron, “The Political Psychology of Redistribution,” 52 *UCLA L. Rev.* 1745, 1753 (2005) [hereinafter *Redistribution*] (contrasting “hidden” and “transparent taxes”).

⁸ For examples of the use of “transparency” in this way, see Block, note 3, at 869 (“In a democratic government, it is important for such decisions to be transparent and open and for legislators to be full accountable.”); Julie Roin, *Truth in Government: Beyond the Tax Expenditure Budget*, 54 *Hastings L.J.* 603 (2003) (arguing for the value of transparency with respect to tax expenditures).

⁹ Thomas Blanton, *The World’s Right to Know*, *Foreign Pol’y*, July 2002, at 50.

¹⁰ The claim that that transparency is foundational often rests on James Madison. See Letter from James Madison to W.T. Barry (Aug. 4, 1822), in *The Complete Madison: His Basic Writings* 337 (Saul K. Padover ed., 1953) (“[A] people who mean to be their own Governors, must arm themselves with the power which knowledge gives.”). For attributions to Bentham and John Stuart Mill, see Joseph E. Stiglitz, “On Liberty, the Right to Know, and Public Discourse: The Role of Transparency in Public Life,” *Oxford Amnesty Lecture*, London 5-6 (Jan. 27, 1999), available at <http://siteresources.worldbank.org/NEWS/Resources/Oxford-amnesty.pdf>.

¹¹ John Rawls, *A Theory of Justice* 16, 454 (1971) (transparency is a necessary condition for a just society so that individuals are informed about their choices in being governed); Fenster, note 1, at (nr. N. 47) (“Openness is a necessary condition of popular democratic power, a predicate for effective representative government, and an indispensable part of the everyday life of the free individual and of the wider demos.”).

Furthermore citizens must have sufficient information to engage in a meaningful public debate about public institutions and government actions.¹² Many of those who argue for “transparency” as a foundational matter are arguing for the government to disseminate information—data surely, but also the manner in which the data is collected or used.

The second claim is instrumentalist. Transparency enables the public to monitor the government and to take actions against incompetency and corruption. Access to information improves criticism and review, enables better government oversight and regulation, promotes better functioning markets, and facilitates improved international relations.¹³ Lack of access to information about government benefits and government spending may cause voters to make poor political decisions about which elected officials and which laws to support. Another consequentialist claim is economic—in general access to information should promote better resource allocation and efficiency. Hidden information may enable those who have the information to extract rents.

But even advocates of transparency agree that absolute transparency is neither desirable nor necessary. For logistical and financial reasons, the government could not function if every meeting involving government personnel or every document passing through a government agency must be provided to all citizens.¹⁴ Significant privacy concerns arise in requiring the government to release private information that must be disclosed to the government. There are also concerns over security breaches, the quality of government decisionmaking, and the effects on competition in the marketplace.¹⁵ So, for example, Congress does not open its doors to all Committee meetings, defense and security matters are exempted from FOIA, and tax return information cannot be disclosed.¹⁶

¹²See, e.g., Amy Guttmann & Dennis Thompson, *Democracy and Disagreement* 100-01 (1996); James G. March & Johan P. Olsen, *Democratic Governance* 146-48 (1995); see also Fenster, note 1, at 896 (“In short, liberal democratic theory requires the state to give an account of itself to its public and to justify its action to the individual and community.”); Stiglitz, note 10, at 7 (arguing that the most compelling argument for openness is that meaningful participation in democratic processes requires informed participants).

¹³ See Fenster, note 1, at 899-902 (cataloguing the consequentialist claims for transparency); Stiglitz, note 10, at 27.

¹⁴ Fenster, note 1, at 902 (“Government cannot operate in a manner that provides complete access to all proceedings and documents. Complete transparency not only would create prohibitive logistical problems and expenditures. . . , but more importantly, it would impede many of the government’s most important operations. . . .”)

¹⁵ See *id.* at 906-10 (cataloguing limitations on transparency); Stiglitz, note 10, at 18-25. There are also those who argue that the benefits from transparency are minimal, see, e.g., Neal D. Finkelstein, Introduction: Transparency in Public Policy, in *Transparency in Public Policy* 1, 1 (Neal D. Finkelstein ed., 2000), that transparency may cause constitutional harms, see, e.g., Antonin Scalia, *The Freedom of Information Act Has no Clothes*, Regulation, Mar./Apr. 1982, and that there are negative, perhaps unintended consequences, such as security breaches, greater access to information by criminals, increased fiscal costs, loss of privacy, and an inability to govern because of sunshine, see, e.g., James T. O’Reilly, *FOIA and Fighting Terror: The Elusive Nexus Between Public Access and Terrorist Attack*, 64 *La. L. Rev.* 809, 812-14 (2004); Laura A. White, *The Need for Governmental Secrecy: Why the U.S. Government Must Be Able to Withhold Information in the Interest of National Security*, 43 *Va. J. Int’l L.* 1071 (2003); Fenster, note 1, at 907-08, 936-38.

¹⁶ See Sen. R. XXVI (allowing committee meetings to be closed to the public for enumerated reasons, including, “the interest of national defense or the confidential conduct of the foreign relations of the United States”); 5

How transparency as a core principle is to be carried out is less certain. The general idea is that the government should operate in the open and not in secret and should strive to make information available to the public. Joseph Stiglitz described this type of transparency as “a basic right to know, to be informed about what the government is doing and why.”¹⁷ Some aspects of transparency are so ingrained as to not need legislation. For example, congressional sessions are scheduled and open to the public, hearings are public, and legislation is printed and widely distributed. Other aspects of open government have been legislated to require the government to both act in the open and to make information available. For example, the Government in the Sunshine Act requires federal agencies to open certain meetings to the public.¹⁸ The Freedom of Information Act requires the government to release certain information to the public.¹⁹ Although the key component is that information should be available to voters, it is well accepted that the information must be accessible, complete, relevant, and reliable.²⁰

In the tax arena, transparency is widely perceived to be a desirable trait of government, but what is meant by that is somewhat clouded. Some of what is required is already in place but other manifestations of transparency are limited or ineffective. Legislation and regulations are publicly available.²¹ Citizens must have the opportunity to provide input on legislation and regulation. The APA and internal rules generally provide for the opportunity for anyone to comment on regulations,²² but it is much more difficult to comment on other administratively-issued rulings. While Congress often holds hearings with respect to legislation, there are two significant problems. The first is that while almost all hearings are open to the public, it is generally not possible for citizens to regularly provide input. The legislation that ultimately is adopted is not necessarily the legislation on which hearings are held. Committee deliberations and mark-ups are closed to the public so it is often difficult for citizens to understand Congress’ intention. One way in which there is a significant lack of transparency is the extent to which special interests control the legislative process. Cloaking the process in darkness hides the extent to which legislation provides special benefits, such as tailored transition rules. A lack of

U.S.C.A. § 552(b) (West 2009) (exempting certain information from FOIA requirements “in the interest of national defense or foreign policy”); IRC § 7216 (prohibits disclosure of tax return information by tax return preparers).

¹⁷ Stiglitz, note 10.

¹⁸ Pub. L. No. 94-409, 90 Stat. 1241, (1976) (codified at 5 U.S.C. § 552(b)).

¹⁹ Pub. L. No. 89-487, 80 Stat. 250 (1966) (codified at 5 U.S.C. § 552).

²⁰ See, e.g., Vishwanath & Kaufmann, note 6. Another manifestation that sometimes appears in the literature with respect to the rule of law is the requirement that legislation not only be accessible but also comprehensible. This, however, concerns complexity and is discussed in the next section.

²¹ See GPO Access, <http://www.gpoaccess.gov> (provides free on-line access to official information, including laws, regulations, and Supreme Court opinions).

²² Add cite

information will cause voters to make poor decisions about government spending and revenue raising.

B. Complexity

Like transparency, complexity has many meanings, which often overlap both transparency of process and salience. As David Bradford noted, there are multiple kinds of complexity plaguing the tax system. The first is compliance complexity, which refers to the difficulties that taxpayers face in recordkeeping, making calculations, filing the return and complying with the regulations imposed by the Internal Revenue Service. The second is transactional complexity, which refers to the costs and efforts taxpayers face in changing their behavior to minimize their tax liabilities. The third type of complexity is rule complexity, which refers to the difficulty in understanding and interpreting legislative and regulatory rules.²³ Complexity generally then refers to a taxpayer's ability to understand and comply with a statutory provision or regulations. As we shall see, like salience, the complexity of tax provisions can effect or change taxpayer behavior. Transactional complexity itself encapsulates that aspect because it references behavioral changes that occur because of the tax rules.

Complexity can of course refer to process—thus it would not be incorrect to note that the process of enacting tax legislation is quite complex. But to clarify the argument, I want to limit transparency to process and complexity to the legislation/regulation and taxpayers' behavior with respect to the legislation/regulation.

C. Salience

Salience is often confused with both transparency and complexity and for purposes of my argument, I want to distinguish it and assign it a specific meaning. Salience has relevance in a number of academic disciplines and although the meaning is not completely consistent, it is usually a variation of the dictionary definition of “standing out conspicuously” or “prominent.”²⁴ Political scientists, for example, utilize “salience” to describe the issues that voters care about²⁵ and various theories modeling political manipulation argue that politicians engage in changing the relative salience of issues confronting voters.²⁶ Psychologists and sociologists use the concept to demonstrate that the prominence of something may affect an individual's behavior.²⁷

²³ David F. Bradford, *Untangling the Income Tax* (1986).

²⁴ Merriam Webster Online Dictionary.

²⁵ Macartan Humphreys & John Garry, *Thinking About Salience*, (unpublished paper 2009), available at <http://www.columbia.edu/~mh2245/papers1/salience.pdf>

²⁶ See, e.g., Willer Riker, *The Art of Political Manipulation* (1986).

²⁷ See, e.g., Leslie K. John, Alessandro Acquisti & George Loewenstein *The Best of Strangers: Context-dependent willingness to divulge personal information*, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1430482 (authors show that the salience of concerns about privacy motives caused the subjects to be less willing to admit to sensitive behaviors) ; Shelley E. Taylor, *The Availability Bias in Social Perception and Interaction*, in *Judgment Under Uncertainty: Heuristics and Biases* 190, 192 (Daniel Kahneman et al. eds., 1982) (“Salience biases refer to

Behavioral economists refer to salience as a bias in favor of prominent or visible information that affects people's behavior and responses.²⁸

It is this sense of prominence or visibility that I attach to the term salience.²⁹ With respect to taxation, salience is used to describe the degree to which a tax or a tax provision is visible or prominent to the public. Many commentators refer to low-salience taxes as “hidden taxes.”³⁰ But “hidden tax” is a misnomer. The taxes that are commonly labeled as hidden (a VAT, a non-inclusive sales tax) are not actually hidden in the commonsense meaning of the word. Information about the tax—most importantly the rate and the commodities on which it is imposed—is readily available to the public.³¹ This is true with respect to specific tax provisions as well. It is hard to think of a tax—or even a provision of a tax—that is hidden in the sense of being unknown or about which information is unavailable.³² In every case the information about the tax—the rates, how it is imposed, how it is collected—is available. In every case, the taxes are “hiding” in plain sight. Thus salience refers to prominence, not unavailability. The tax

the fact that colorful, dynamic, or other distinctive stimuli disproportionately engage attention and accordingly disproportionately affect judgments.”)

²⁸ For salience effects not relating to tax, see, e.g., T. Hossain & J. Morgan, “Plus Shipping and Handling: Revenue (Non) Equivalence in Field Experiments on eBay,” 62 *Advances in Econ. Analysis and Pol’y* (2006).

²⁹ Another characteristic of something that is salient is that it is easy to process. Edward J. McCaffrey & Jonathan Baron, *Isolation Effects and the Neglect of Indirect Effects of Fiscal Policies*, 19 *J. Behavioral Decision Making* 289, 289 (2006) [hereinafter *Isolation Effects*].

³⁰ See, e.g., Brian Galle, *Hidden Taxes*, 87 *Wash. U. L. Rev.* 59 (2009); C. Eugene Steuerle & Martin A. Sullivan, “Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations,” 12 *A. J. Tax Pol’y* 399, 446 (1995) (referring to “hidden tax rates”); William Congdon, Jeffrey R. Kling & Sendhil Mullainathan, “Behavioral Economics and Tax Policy,” 8 (NBER Working Paper 15328, 2009), available at <http://www.nber.org/papers/w15328>; Jacob Nussim, *Taxes, Prices, and Consumer Protection*, at 45, unpublished paper, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1397643; McCaffery & Baron, *Isolation Effects*, note 29, at 289; Lohman & Weiss, note 3; Philip J. Harmelink & Phyllis V. Copeland, “Hidden Taxes’ Through Phaseouts and Floors: Assessment and Policy Implications,” 58 *Tax Notes* 77 (1993); Maureen B. Cavanaugh, “On the Road to Incoherence: Congress, Economics, and Taxes,” 49 *UCLA L. Rev.* 685, 697 (2001); . George Loewenstein, Deborah A. Small & Jeff Strnad, “Statistical, Identifiable and Iconic Victims,” in *Behavioral Public Finance* (Edward J. McCaffery & Joel Slemrod eds., 2006) (describing a hidden tax “in its pure form is one where all of the possible ultimate payors believe that the tax is being paid by someone else.”). McCaffery & Baron use the term “hidden taxes” in two ways. They describe “partially hidden taxes” as those where the tax is built into the price—such as a VAT or excise tax—where the amount of the tax is known. In their terminology “fully hidden taxes” are those where the incidence of the tax is not known, such as corporate or business taxes. McCaffery & Baron, *Isolation Effects*, note 29, at 289.

³¹ Lohman & Weiss, note 3, at 584 (“After all, tax rate information is “public information” in the sense that the public has access to government publications listing tax rates on all sorts of economic activities in exhaustive detail.”); Edward J. McCaffery, “Cognitive Theory and Tax,” 41 *UCLA L. Rev.* 1861, 1873 (1994) (“a ‘hidden’ tax can actually be quite certain and knowable”).

³² Contrast a tax rule in which taxpayers drew a slip of paper out of a big black box that announced their marginal tax rate. There the process of determining the rate and the information about the rates themselves would actually be hidden.

or provision is in the open, but less visible than other taxes or provisions. Taxpayers simply fail to observe it or to use available information.

It is useful to think of salience in terms of behavioral effects. A tax burden motivates behavioral change but if the effects are not readily available to taxpayers, then one would expect less response. A salient tax (or tax provision) is predicted to affect taxpayer behavior; conversely, a low-salience tax (or provision) predictably would change behavior less or not at all. If taxpayers are unaware of the tax or provision, then they cannot respond to it; if the tax or provision is not prominent, they will under-react. Thus, salience is relevant even where the tax or provision is known.

While the concept of salience is clear—visibility or prominence—its application to taxes may manifest itself in a variety of ways. It is useful to catalogue some of them.

- Individuals may be completely unaware of the tax. Many people who pay a tax or who bear the burden of the tax may be uninformed of its existence. Excise taxes on various commodities are largely unknown. So too are many business-level taxes, such as manufacturer's excise taxes.
- Individuals may be aware of the tax but be unsure of its base. For example, taxpayers may be cognizant of gasoline taxes but unaware which fuels are subject to them. Or they be familiar with Social Security taxes but do not know if they apply to fringe benefits as well as wages.
- Individuals may be aware of the tax but not its incidence.³³ The structure of the tax affects its salience. For example, both the corporate tax and the payroll tax have low salience for owners and workers because the incidence of the tax is either unclear or not prominent. Many assume that the corporate tax and the employer portion of Social Security create no tax burden for them.
- Individuals may be aware of the tax but do not know how much tax they pay. The way in which the tax is levied affects salience—a tax-inclusive price may be much less prominent than a tax-exclusive tax. An excise tax bundled into the advertised price may be difficult to ferret out.
- Individuals may be given complete information about the tax but choose to ignore it in making decisions. A sales tax that is added at the cash register or a VAT noted on a receipt may not be noticed.
- Individuals may very aware of the tax and have lots of information about the tax but be unable to calculate their own tax burden either because they do not understand the rate or the base. The income tax is a good illustration of a well-known tax whose various

³³ The incidence of a tax may not be clear because the tax may cause price changes that shift the burden from the person who remits tax to the government to someone else. An individual may believe that the payor of the tax bears its burden rather than the person with the actual burden.

provisions and their effect may not be understood. For example, interaction between various provisions may obscure their effects. For instance, the nominal marginal tax rate is quite salient but often it does not apply because other provisions, such as income ceilings and phase-outs, have the effect of increasing the rate. The consequences of tax provisions can also be masked by other provisions that cut in the opposite direction or by direct spending that counteracts taxation. For example, Congress could heavily tax an industry nominally and at the same time provide tax incentives or direct spending so that the tax burden on the industry is of low salience.

- Individuals may not understand the economic effect of a “tax” because it is implicit rather than explicit. Thus where the tax exemption for municipal bonds is fully capitalized into their price (the pretax income is reduced by the statutory tax rate), the holder bears an implicit tax that is never labeled as such.
- The method of payment of a tax also affects its salience. Paying the tax in small, incremental amounts may make the details of the tax far less visible than making a large lump sum payment. For example, withholding of income tax may obscure the total amount paid as well as the tax rate. Payment of a property tax annually or even quarterly by check makes it more visible whereas using a tax escrow arrangement in connection with a mortgage makes it less so.³⁴

With respect to taxes, salience and complexity overlap in several ways but they are not identical. If a tax is difficult to compute or to process, it is likely to be less salient. For example, a noninclusive sales tax may be less salient because it is difficult to compute. Many income tax provisions are so complex that they lose their salience.³⁵ More complex taxes create more opportunities for salience to be an issue.

But very simple provisions may not be salient. Most sales taxes, for example, are relatively simple—a flat percentage of the purchase price of a commodity—but depending on the way in which they are presented, they may be of low salience. Conversely, some highly complex provisions may attain great prominence in the political debate. The earned income tax credit has very complex definitional rules and requires complex calculations but its existence, at least, and the possibility of the receipt of large checks, has high salience.

III. What We Know About Salience and Taxes

³⁴ See Marika Cabral & Caroline Hoxby, *The Hated Property Tax: Salience, Tax Rates, and Tax Revolts*, available at http://economics.stanford.edu/files/Hoxby3_2.pdf

³⁵ See, e.g., Lawrence J. Kotlikoff & D. Rapson, “Does it Pay, at the Margin, to Work and Save?—Measuring Effective Marginal Taxes on Americans’ Labor Supply and Saving (NBER Paper No. 12533, 2006), available at <http://www.nber.org/papers/w12533> (“thanks to the incredible complexity of the U.S. fiscal system, it’s impossible for anyone to understand her incentive to work, save, or contribute to retirement accounts absent highly advanced computer technology and software.”)

Although the argument I make is a political economy argument, most of what we know about salience comes from work that looks at the effect of salience on economic decisionmaking. It is that work that allows us to speculate on the effect of salience on political decisions with respect to taxes.

A. Empirical Work

The argument that salience is relevant to taxes derives from behavioral economics. In this branch of economics, economists apply the concepts of cognitive psychology, specifically certain biases, to economic decisionmaking. They argue that individuals do not always act “rationally” in making economic decisions³⁶ and often systematically deviate from what would be expected from a rational, self-interested individual. Therefore the standard assumptions made in the prevailing model of decisionmaking do not hold.³⁷ They posit that individuals do not necessarily act rationally, that they are not always self-interested, and that they hold inconsistent preferences.

The relevance of salience is usually traced to Amos Tversky & Daniel Kahneman, who laid out several heuristics used by individuals that biased decisionmaking.³⁸ The relevant one here is “availability.” In making a decision, individuals are often biased in that they rely too heavily on information that is readily available or prominent, ignoring information that they do not see as often or as readily or that is in the background. They noted that “availability is affected by factors other than frequency and probability....such as salience.”³⁹ Thus, the salience of an object or idea is one factor that may cause the availability heuristic to affect behavior. Other economists began to study the extent to which these biases and heuristics, including salience, affected economic decisionmaking⁴⁰ They tested whether in fact individuals did use various

³⁶ The standard rational actor model posits that “all human behavior can be viewed as involving participants who maximize their utility from a stable set of preferences and accumulate an optimal amount of information and other inputs in a variety of markets.” Gary S. Becker, *The Economic Approach to Human Behavior* 14 (1976).

³⁷ Early applications were modifications of the standard rational actor model that led to the idea that individuals have bounded rationality. See, e.g., Herbert Simon, *Reason in Human Affairs* (1983). Modern behavioral economics of course does more than point out that assumptions in standard economic models do not hold in actuality. Behavioral economists generally argue that these assumptions are consistently violated and therefore are not useful as assumptions for modeling. As a result, the modeling itself is invalid. Behavioral economics is not universally accepted. Many mainstream economists reject it entirely. For a review of the stand-off and a discussion of the sources of skepticism, see B. Douglas Bernheim, *On The Potential of Neuroeconomics: A Critical (But Hopeful) Appraisal* (NBER Working Paper 13954, 2008), available at <http://www.nber.org/papers/w13954>. I do not need to take a position in this debate about the validity of the standard model of decisionmaking. Insights about cognitive biases are relevant for tax policy design regardless of whether they upend standard economic models.

³⁸ Amos Tversky & Daniel Kahneman. “Judgment Under Uncertainty: Heuristics and Biases,” 185 *Science* 1124 (1974).

³⁹ *Id.* at 1127.

⁴⁰ For an early application of the cognitive psychology concept of salience to economic theory, see George A. Akerlof, “Procrastination and Obedience,” 81 *Amer. Econ. Rev.* 1 (1991). Akerlof argued that individuals systematically failed to maximize their utility. He applied what he described as “a central principle of modern cognitive psychology” under which individuals attach too much weight to salient events.

heuristics to make decisions. Generally, they demonstrated that when something is more salient, (meaning more prominent or visible), it had a more pronounced effect on people's behavior and responses.⁴¹

In the last decade researchers have begun to consider whether cognitive biases apply to decisionmaking with respect to taxes.⁴² Some empirical work and modeling has been done to explore whether the salience of a tax affects behavior and the ways in which it might do so. Our understanding of this literature can illuminate how Congress might use salience as a fiscal tool.

In a widely-cited empirical study, Chetty, Looney & Kroft focused on the extent to which salience affected a consumer's perception of price and how that affected demand for a consumer product. They concluded that "individuals know about taxes when their attention is drawn to the subject, but do not pay attention to taxes that are not transparent when deciding what to buy."⁴³ The study established that although most consumers knew the rate of the applicable sales tax in the location where they were shopping, their behavior was more sensitive to after-tax prices when the amount of sales tax was posted (i.e. quite visible). Their experiment was conducted in a supermarket where posted prices generally were exclusive of sales tax (i.e. the tax was added at the register so that a consumer needed to know the amount of the tax and do a calculation in order to decide whether to purchase based on the total price). To test whether consumers underreacted to the tax-exclusive sales price, they also posted price tags displaying the tax-inclusive price. The study showed that the tax-inclusive price reduced demand by close to the amount of the sales tax and from this they inferred that most consumers usually did not take the tax into account in making consumption decisions. Thus, the more salient tax-inclusive price changed consumer behavior more than the less visible tax-exclusive price.⁴⁴ To offset the possibility that some behavioral change could be due to a short-run violation of norms, they also studied the long-term effects of taxes on alcohol consumption. Alcohol is subject to an excise tax included in the retail price and a sales tax added on purchase. Looking at state-level changes in these two taxes along with annual data on beer consumption by state, they found that increases in the excise tax reduced beer consumption by an order of magnitude more than a similar increase in the sales tax.⁴⁵ Again, they conclude that the less salient tax changed behavior less.

⁴¹ Add example studies

⁴² The earliest and most prominent work was done by Edward McCaffery and subsequently with Jonathan Baron. See McCaffery, note 31.

⁴³ Raj Chetty, Adam Looney & Kory Kroft, "Salience and Taxation: Theory and Evidence," 99 Am. Econ. Rev. 1145 (2009). Although they use the term "transparent," it is clear from the study that they are focusing on salience.

⁴⁴ Chetty et al focus on price rather than tax rates because they were interested in behavioral responses to prices rather than to rates. As they note, the tax rate may actually be less visible in a tax-inclusive price but the total price is more visible. Chetty et al, note 43, at 1 n.2.

⁴⁵ Id.

In another empirical study Amy Finkelstein explored the sensitivity of drivers to the salience of tolls collected electronically.⁴⁶ The study examined the impact of the adoption of electronic toll collection on toll rates. Her work is useful on several fronts. First, her survey data indicated that drivers who used EZ Pass did not know either the rate at which the toll was imposed or their periodic costs. EZ Pass is a very low-salience way of collecting tolls because unlike drivers who hand over cash to a toll collector, a driver using EZ Pass has the toll collected automatically as she passes the toll booth. Thus the salience of the level of the tolls was quite low.⁴⁷ Although information about the amount of the toll is readily available,⁴⁸ drivers either ignored the amount of the toll or were unaware of it. Her work produced evidence that the salience of tax increased the elasticity of demand for commuters.

These studies bear out the intuition that unless the amount of the tax is prominent, consumers will make consumption decisions “pretax” even though they are aware that a tax will be imposed and even where calculation of the tax is relatively uncomplicated. One could imagine other economic decisions where this is likely to be true.⁴⁹

There is also some limited work on the effect of salience on the politics of taxation. The Finkelstein study also tested the oft-stated concern that low-salience taxes make it easier for legislators to raise tax rates.⁵⁰ She found robust evidence that toll rates increased after the adoption of electronic collection.⁵¹ The implication is that legislators were less concerned with political backlash from toll increases when the method of collection was of low salience.

A study by Mitral and Hoxby that focused on the politics of the property tax found that areas in which property taxes are less salient were those with higher property tax rates. One key way in

⁴⁶ Amy Finkelstein, “EZ-Tax: Tax Salience and Tax Rates,” 124 *Q. J. Econ.* 969 (2009).

⁴⁷ Surely a significant explanation for the lack of salience is the way in which the funds for tolls on EZ Pass systems are collected. To use the system, the driver must create an EZ Pass account by purchasing via credit card a flat amount (such as \$25), which is used to pay the tolls that the user incurs. Additional amounts are re-loaded automatically via credit card. Anecdotal evidence would support the view that automatic payment and a “bulk” purchase makes the unit charge of low salience. For example, I recently asked a number of colleagues the amount of their monthly health insurance payment—which is automatically deducted from the paycheck. Not one person correctly stated the amount. In another test, none of the six people with whom I was dining, all of whom used monthly purchased Metrocards for the NYC subway, was positive about the current subway fare.

⁴⁸ In many locations, the amount of the toll is posted or flashes on a monitor before it is paid. Alternatively the driver could examine the EZ Pass statement sent to all users. Thus, it cannot be said that the information is hidden; it is of low salience.

⁴⁹ For example, in deciding which entrée to order at a restaurant, a consumer who takes cost into account is likely to choose based on the price for the entrée listed in the menu although the actual price will include tax and tip. Conversely, where the price of the commodity or service is tax-inclusive, decisions are likely to be based on the total cost—for example, parking garage fees that include local taxes or gasoline prices that include excise taxes. Ripe for study might be online airline and rental car bookings to compare those cases where the listed fee does not include all taxes and those cases where it does.

⁵⁰ See discussion below at

⁵¹ Finkelstein, note 46, at .

which property taxes were less salient was the common method of paying the taxes by tax escrow—the property tax is paid by the holder of the mortgage and is lumped together with all payments made to the bank. The study also found that when a state’s tax escrow rises, voters support fewer statewide referenda that limit property taxes. Conversely, when property taxes are more salient, they are lower and more likely to be constrained by limits.⁵²

Sausgruber and Tyran use a laboratory experiment in which subjects earn income in a game and subsequently vote on a proposal to tax transactions and redistribute revenues. The tax proposal is framed as either a direct tax or an indirect one.⁵³ Their study finds that participants systemically underestimate the tax burden of the less-salient tax. Ninety percent of those confronted with the indirect tax vote for tax-redistribution proposals that are not in their self-interest. In contrast, 90 percent of those facing a direct tax vote against proposals that are not in their self-interest.

The salience of a tax—and its effect on taxpayer response—also may be affected by the form in which the tax is levied. The way the tax is framed may make it less prominent.⁵⁴ Both the Chetty and the Finkelstein studies reflect this—in each case the same tax was levied in two different forms, one of which was more salient than the other. It also appears to make a difference whether the tax is being used to raise revenue or to distribute benefits or to affect behavior. Salient taxes appear to be better at distributing benefits. In an empirical study comparing the effects of state sales tax exemptions and income tax incentives for the purchase of hybrid vehicles, Gallagher and Muehlegger found that a sales tax incentive resulted in a significantly larger increase in demand for hybrid vehicles than a comparable income tax incentive.⁵⁵ They attribute this in part to the salience of the sales tax, which is incorporated into the vehicle’s price at the time of purchase, as contrasted to the income tax incentive, which is less well understood and will benefit the purchaser, if at all, only in the following year when a tax return is filed.⁵⁶

⁵² Cabral & Hoxby, note 34.

⁵³ Rupert Sausgruber & Tyran, Jean-Robert, “Tax Salience, Voting, and Deliberation” (Oct. 31, 2008). Univ. of Copenhagen Dept. of Economics Discussion Paper No. 08-21, available at <http://ssrn.com/abstract=1292731>.

⁵⁴ McCaffery & Baron, Isolation Effects, note 29, at 290-1; Aradhna Krishna & Joel Slemrod, “Behavioral Public Finance: Tax Design as Price Presentation,” 10 *Int’l Tax & Pub. Fin.* 189, 190-1 (2004). Behavioral responses may vary with the form of the tax even though two taxes are otherwise equivalent. See, e.g., Tomer Blumkin, Bradley Ruffle & Yosi Ganun, “Are Income Taxes and Consumption Taxes Ever Really Equivalent? Evidence from a Real-Effort Experiment with Real Goods” (2008), unpublished paper, available at <http://www.ec.bgu.ac.il/monaster/site/wp.php?y=all> (finding in a laboratory experiment that different behavioral responses to an otherwise equivalent income tax and a consumption tax).

⁵⁵ Kelly Sims Gallagher & Erich Muehlegger, “Giving Green to Get Green? Incentives and Consumer Adoption of Hybrid Vehicle Technology,” (Kennedy School of Gov’t Working Paper No. RWPO8-009, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083716&rec=1&srcabs=1204716.

⁵⁶ The authors also show that the effect of the income tax incentive is greatest in the second quarter after tax returns are filed and then declines, which is consistent with a story in which individuals received imperfect information about the incentive or are poorly informed about the value of the incentive. *Id.* at 23-24.

Scholars have just begun to focus on the salience aspects of an income tax. One focus is to demonstrate that an income tax is more salient than other types of taxes.⁵⁷ In a series of survey studies, McCaffrey and Baron demonstrated that in considering taxes and other fiscal policies, people tended to focus on the most direct, immediate, and certain effects.⁵⁸ One of the conclusions is that people focused primarily on salient effects of taxes. McCaffrey and Baron, found that “ordinary people seem to have deep-seated tendencies to form quick judgments on matters of tax and economic policy, responding to the most obviously salient aspect of a choice or decision set.”⁵⁹ For example, in one experiment they compared raising money for insurance by either an income tax or a payroll or business tax. Despite some attempt to educate subjects on the redistributive effects of the various taxes, respondents preferred the less salient payroll and corporate taxes to the more salient income taxes.⁶⁰

The other empirical work that explores cognitive bias and income taxes focuses on tax rates. There is some evidence that tax rates are not very salient, as evidenced by the fact that people are unable to determine their own marginal tax rates.⁶¹ If rates were salient, one would expect a behavioral response of earnings to changes in rates. Such a response might occur at “kink points” in the rate schedule where marginal tax rates jump. Saez explored that possibility using annual tax return data for several decades. He first examined kink points created by the phase-in and phase-out of the earned income tax credit. He found that wage earners did not respond significantly to the EITC incentives created by the phase-out and phase-in.⁶² The self-employed, however, showed significant bunching but only at the first kink point and the bunching was not consistent.⁶³ Saez also examined behavioral responses to kinks in the marginal rate tax schedule and found evidence of a behavioral response to the first kink (i.e. from a zero rate to a positive rate) but no evidence at other kink points. Although Saez offers a number of explanations for his findings, one relevant possibility is that it is difficult for taxpayers to understand a complex tax system and the first kink point is “likely to be more salient and easier to understand than other kink points.”⁶⁴

⁵⁷ See, e.g., McCaffery, note 31, at 1903.

⁵⁸ McCaffrey & Baron, Isolation Effects, note 31.

⁵⁹ *Id.* at 300.

⁶⁰ McCaffery & Baron, Redistribution, note 7, at 1761-65. The authors refer to this as “hidden tax bias.”

⁶¹ Edwin T. Fujii & Clifford B. Hawley, “On the Accuracy of Tax Perceptions,” 70 *Rev. Econ. & Statistics* 48 (1988); Peggy A. Hite & Michael L. Roberts, “An Experimental Investigation of Taxpayer Judgments on Rate Structure in the Individual Income Tax,” 13 *J. of the Am. Tax Ass’n* 47 (1991).

⁶² Emmanuel Saez, “Do Tax Filers Bunch at Kink Points? Evidence, Elasticity Estimation, and Salience Effects,” 14 (unpublished paper, 2009), available at <http://elsa.berkeley.edu/~saez/saezAEJ09bunching.pdf>. He notes that there are explanations for his findings that may have little to do with salience: low intensive elasticity of earnings with respect to marginal tax rates, ignorance of the incentives, inability to adjust labor supply, and inability to misreport earnings.

⁶³ *Id.* This may be due to the increased flexibility to adjust labor supply or ease in cheating.

⁶⁴ *Id.* 23-24.

There is some literature indicating that average tax rates are more salient than marginal tax rates.⁶⁵ As a result, people probably engage in what Leibman and Zeckhauser call “schmeduling,” the act of behaving as if one were facing a misperceived schedule instead of the actual schedule.⁶⁶ The authors found that one variant of that is ironing, under which an individual perceives an average rate rather than a marginal rate.⁶⁷ Apparently the actual marginal tax rate is not salient.⁶⁸

Salience also affects the delivery of information to individuals. If a communication is salient, it may convey information that might change behavior. Conversely, a non-salient communication may fail to convey the necessary information, resulting in no behavioral change. A number of studies have shown that additional information affects decisionmaking.⁶⁹ Chetty & Saez have added to this literature in the tax area by demonstrating that providing additional information about the earned income tax credit affects labor supply.⁷⁰ They view their contribution as “showing that the impacts of tax policies depend on the way in which individuals are taught about the tax system.”⁷¹ One relevant salience finding was that the information had an effect because it was provided at the time that the individuals were thinking about taxes.

In sum, current work shows that the salience of a tax may affect economic decisions, particularly consumption decisions. If the tax is not very salient, there will be no change in response or less change in response than there would have been had the tax been more visible. This means that the taxpayer’s pretax and after tax response may be the same. Ordinarily one would expect the

⁶⁵ Shaun Bowler & Donovan Todd, “Popular Responsiveness to Taxation,” 48 Pol. Res. Q. 79 (1995); C.V. Brown, “Misconceptions About Income tax and Incentives,” 15 Scottish J. of Pol. Econ. 1 (1968); N.L. Enrick, “A Further Study of Income Tax Consciousness,” 17 Nat’l Tax J. 319 (1964); Bruce L Gensemer, Jane A. Lean & William B. Neenan, “Awareness of Marginal Income Tax Rates Among High-Income Taxpayers,” 18 Nat’l Tax J. 258 (1965). These are all survey studies that may or may not reflect the extent to which average tax rates rather than marginal tax rates influence behavior.

⁶⁶ Jeffrey B. Liebman & Richard J. Zeckhauser, “Schmeduling,” (unpublished paper 2004), available at <http://www.hks.harvard.edu/jeffreyliebman/schmeduling.pdf>

⁶⁷ Their example of ironing is an individual with \$80,000 of wages who is in a 30 percent bracket and pays \$16,000 of tax, and assumes that his tax rate is 20% and that he will keep 80% of marginal earnings. *Id.* at 3. See Charles A.M. de Bartolome, “Which Tax Rate Do People Use: Average or Marginal?,” 56 J. Pub. Econ. 79 (1995). De Bartolome ran a laboratory experiment in which he tested whether people used average or marginal tax rates in making investment decisions and found that a significant number used the average rate. He also found that converting tax tables that simply provide taxes without a marginal rate into a schedule that listed the marginal rate increased the numbers who used the marginal rate.

⁶⁸ This may be in part because taxpayers do not have accurate real time information. See text accompanying notes...

⁶⁹ See, e.g., Esther Duflo & Emmanuel Saez, “The Role of Information and Social Interactions in Retirement Plan Decisions: Evidence from a Randomized Experiment,” 118 Q. J. Econ. 815 (2003).

⁷⁰ Raj Chetty & Emmanuel Saez, “Teaching the Tax Code: Earnings Responses to an Experiment with EITC Recipients,” NBER Working Paper No. 14836, 2009), available at <http://www.nber.org/papers/w14836>.

⁷¹ *Id.* at 5.

existence of a tax to affect prices and thus demand. With respect to a commodity, a consumer aware of a tax on a product would consume less than she would in the absence of the tax. If the consumer is unaware of the existence of a tax, then the tax will not affect her decision about whether to purchase or the amount to purchase.⁷² In addition work with respect to the income tax shows that some aspects of a very salient tax—particularly rates—are themselves not very salient.

B. Why Do People Ignore (or Misperceive) Taxes?

In thinking about exploiting salience in designing taxes, it is helpful to understand the various heuristics at work. Several cognitive biases may explain why the increased salience of a tax changes consumer response.⁷³ If Congress were to attempt to use salience as a fiscal tool, it is helpful to know how deep-seated biases are and whether they can be easily overcome.

The effects of low-salience taxes might be explained by “the isolation effect,” which is generally understood to mean that individuals pay attention to information or issues immediately before them and fail to take into account relevant information that is not immediately available.⁷⁴ This explanation assumes that people may have the relevant information but ignore it because it is not immediately available, either because it is not prominent or because there are costs in obtaining the information. In a companion paper to the above-described study, Chetty et al (2007) explain their findings by theorizing that individuals incur costs when they must calculate the tax in tax-exclusive prices.⁷⁵ They argue that it is possible that consumers may engage in a kind of cognitive loafing. The existence of the tax is known but consumers do not take the time to compute the tax-inclusive price of a product, perhaps because the utility gained from not doing the calculation exceeds the savings. Chetty assumes a rational taxpayer—that is the taxpayer

⁷² That is not to say that there are not costs. The consumer who incorrectly perceives the cost of a product where the tax cost is not visible or clear may spend more than she otherwise would on that product, thus distorting her choice.

⁷³ There are cognitive biases other than those attributable to availability that may contribute to the undervaluation or ignorance of taxes. Salience probably does not do all the work. For example, the presentation or framing of prices may affect consumer decisions. See generally Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 *J. Bus.* S251 (1986). Anchoring bias--where an individual anchors a decisionmaking to a starting point, failing to adjust to new information--may cause consumers to presume that the final price is closer to the original price (i.e. the anchor) than to some other price. See Tversky & Kahneman, note 38, at 1128. Particularly where consumers are estimating the tax, they may choose a total sales price closer to the posted tax-exclusive price than the tax-inclusive price. It is also probable that taxpayers are unable to combine the effects of various tax systems, suffering from what McCaffery & Baron call “disaggregation bias.” Edward J. McCaffery & Jonathan Baron, “The Humpty Dumpty Blues: Disaggregation Bias in the Evaluation of Tax Systems,” 91 *Organ. Behav. and Human Decisions Processes* 230 (2003). This is similar to mental accounting, where individuals account for related items separately. See Richard Thaler, “Mental Accounting Matters,” 12 *J. Behav. Decision Making* 183 (1999). Finally optimism bias, which causes a person to undervalue negative effects—like taxes—may cause consumers to undervalue the tax. See David A. Armor & Shelley E. Taylor, “When Predictions Fail: The Dilemma of Unrealistic Optimism, in *Heuristics and Biases: The Psychology of Intuitive Judgment* 334 (Thomas Gilovich et al. eds., 2002).

⁷⁴ McCaffery & Baron, *Isolation*, note, 29, at 290; Edward J. McCaffery & Jonathan Baron, “Thinking About Tax,” 12 *Psych. Public Pol’y & L.* 106, 107 (2006).

⁷⁵ Chetty, Looney & Kroft (2007).

deliberately ignores the tax to avoid the disutility of computing the tax as part of the process of weighing their options.⁷⁶

What might account for this disutility? The most obvious possibility is costs—the costs of calculating a tax outweigh the benefit of doing so. Even with respect to the sales tax on a single purchase, the value of the time to calculate the total price may outweigh any change in the decision to purchase due to the small amount of sales tax. Presumably if the cost of calculating the tax (which would include the cost of uncovering the information about the tax and the actual calculation of the tax owed) exceeds the cost of ignoring the tax (which is the tax itself minus the time not spent on calculation), the consumer will not take the tax into account. But of course cognitive biases may cause the consumer to calculate the tax incorrectly or even to be ignorant of the need to calculate the tax.

McCaffrey and Baron also suggest that taxpayers may ignore “hidden taxes” because of a combination of the endowment effect and loss aversion. The endowment effect refers to the finding that people value an object they own more than an object they do not. Loss aversion refers to the fact that people consistently are less concerned with failing to gain some amount than they are with losing that same amount; their reaction to the loss is disproportionate to the economic loss. This would explain the reaction to taxes that are less visible because the incidence is unknown, for example, the employer’s contribution to Social Security or corporate taxes, because the taxpayer does not believe that she is losing something that belonged to her. The tax is not *directly* paid by the taxpayer and thus there is no aversion to losing what she owns.⁷⁷

Another possibility is strategic ignorance. While taxpayers subconsciously know about a tax, they may avoid taking it into account because they know that it might in fact affect their behavior in ways that they would not like.⁷⁸ Inattention may also be attributable to complexity—if a law or provision is extremely complex, one would expect the salience of the law or provision to decrease.⁷⁹ Or a consumer may be unable to compute the tax and if so, he simply ignores it. Another possibility is that taxpayers are ignorant of the taxes and thus fail to take them into account.⁸⁰ There are a number of possible explanations for this ignorance. People may simply be unaware of the tax. While it is unlikely that individuals are unaware of the existence of say, a sales tax or an income tax, they may unfamiliar with the details or various provisions. There are

⁷⁶ Galle calls this an “intentional” model of hidden taxes.” Galle, note 30, at ...

⁷⁷ McCaffery & Baron, *Isolation*, note 29, at 290; see also McCaffery & Baron, *Thinking*, note, 74, at 119.

⁷⁸ See Juan D. Carrillo & Thomas Mariotti, *Strategic Ignorance as a Self-Disciplining Device*, 67 *Rev. Econ. Stud.* 529, 529, 531, 541 (2000).

⁷⁹ See Raj Chetty, “The Simple Economics of Salience and Taxation” 1 (NBER Working Paper 15246, 2009), available at www.nber.org/15246 (noting that inattention to taxes may be prevalent “because tax systems are complex and nontransparent”).

⁸⁰ These taxpayers might be said to be “irrational” in that they do not maximize welfare. Galle calls this an “unintentional” model of hidden taxes. Galle, note 30, at

other taxes, however, of which they may be totally unaware—such as the corporate tax or various excise taxes--or at least unaware that the incidence of the tax might fall on them.

C. Salience and Income Taxes

Given the state of our knowledge about salience and income taxes, we can only speculate about how salience affects taxpayer behavior. It is widely agreed that an income tax is a very salient tax. It is highly visible and almost everyone is aware of the tax either through withholding or payment, political rhetoric, or general public discourse. Thus, one would expect behavioral responses generally to the tax. For example, we might assume that if taxpayers were aware of and correctly understood their tax burden, they might supply a different amount of labor than they would in the absence of the tax—much as consumers acquire less goods in response to a commodity tax. Although it seems highly likely that laborers would respond in some way to the tax burden, in reality we cannot be sure of the exact response because it is unlikely that taxpayers accurately assess their tax burden. This may be because they do not have sufficient information at the time they would make a behavioral response to the burden. For example, the tax rate that will apply to the labor earnings may be unknown at the time they decide how much labor to supply. Congress may subsequently alter the law, changing tax rates or tax brackets. Or later in the taxable year events may occur that increase the taxpayer's income (and therefore the marginal rate) that cannot possibly be known at the time the taxpayer decides whether to supply labor. For example, investment income might unexpectedly increase.

But it is also possible that while the taxpayer's tax burden might be knowable (or available), a cognitive bias can cause the taxpayer to act on imperfect knowledge. For example, the individual's actual after-tax wage rate may differ from his perceived after-tax wage rate and that may cause the individual to supply more or less labor than he otherwise would. Although the income tax itself is quite prominent, its effects may not be because of the complexity or other features of the tax. Taxpayers may be unable to assess their actual tax burden and thus their behavior will respond to the perceived burden. This may be due to significant monetary costs (such as hiring an accountant) or opportunity costs (such as trying to understand the law themselves) incurred in obtaining the necessary information to calculate a tax. The complexity of an income tax may also impede such knowledge. Much of the information about taxes is highly specialized and complex, particularly with respect to the income tax, making the price of acquiring it often significant. There are many uncertain variables in the law that make it impossible to calculate the effective or even marginal tax rate. For example, the effective rate on capital income depends on the length of time the asset producing the income is held, future interest rates, future discount rates, and the extent to which the market levies an implicit tax on the asset due to the tax advantage of deferral. Even the marginal tax rate on wages can be extremely difficult to calculate, given various deductions, phase-outs, etc. The burden of various taxes may also be difficult to compute because the incidence of a tax may be unknown or misunderstood. For example, it is widely believed that the incidence of the corporate tax falls in part on both shareholders and consumers, but the exact degree to which each group bears a burden is controversial.⁸¹ Perhaps more important for this purpose, one would assume that the

⁸¹ See, e.g., William A. Klein, *The Incidence of the Corporation Income Tax: A Lawyer's View of a Problem in Economics*, 1965 *Wis. L. Rev.* 576, 602 (concluding that “the question of incidence is wholly unanswerable”).

overwhelming majority of consumers and owners are unaware that they at least share the burden of the corporate tax. If so, their behavioral response to the tax should be different than it would be if the exact incidence was known and understood. Similarly, many workers are unaware that they bear the burden of both portions of Social Security since the employer's share is passed on to the employee.

Furthermore, select provisions of an income tax may be of low salience. There are likely several reasons for the lack of prominence. The provision may be of low visibility because it was passed without much fanfare, it was not highlighted by the administrative agency administering the provision, and it has received little media attention. That might result in taxpayers failing to take action that would trigger the provision or being unaware that the action they take carries a tax consequence. Alternatively the provision itself might be of low salience in the sense that taxpayers know about it, but its effect could be unknown. The effect is often unknown because of the interaction of various provisions or because one provision is much more salient than another. Phase-outs and rate bubbles are good examples. The nominal top marginal rate is extremely prominent but the actual top rate is not because the effect of phase-outs is quite complex.

* * *

In summary there is convincing evidence that cognitive biases affect decisionmaking and that these biases operate with respect to taxes. People are likely to focus on that which is available—particularly information that is prominent or salient. Taxes or aspects of a particular tax may be more or less salient, which depends in part on their complexity, incidence, and the way in which it interacts with other taxes and provisions. The increased salience of a tax increases consumer response; low-salience taxes change behavior less. From this we might posit that taxpayers are less likely to pay attention to or object to low-salience taxes.

IV. Salience as a Fiscal Policy Tool

A. The Argument and Examples

Generally commentators assume that cognitive biases lead to poor decisionmaking, inefficiencies, and other problems (catalogued below) and that either public or private correctives are in order.⁸² The implication is that legislators should not take advantage of

⁸² See, e.g., McCaffery & Baron, *Thinking*, note 74, at 110, 127. The authors argue that “hidden taxes” will cause citizens to under-react to a loss of the money taken by such taxes which will ultimately lead to less utility and a loss of wealth. They also note that the so-called “flypaper effect” will cause hidden taxes to stick, raising new revenue rather than replacing other sources of revenue. For the “flypaper effect,” see James R. Hines Jr. & Richard Thaler, “The Flypaper Effect,” 9 *J. Econ. Persp.* 217 (1995). But see Elizabeth Becker, *The Illusion of Fiscal Illusion: Unsticking the Flypaper Effect*, 86 *Public Choice* 85-102 (1996). McCaffery & Baron recommend education (debiasing), political constraints (like PAYGO), and structural reform (e.g. competition in tax design). McCaffery, *Thinking*, note 74, at 129-32.

cognitive biases is designing taxes.⁸³ I argue, however, that there may be circumstances where it is appropriate for legislators to do so.⁸⁴

There are two possible types of behavioral responses to the salience of the income tax or its provisions. The first behavioral response is a change in individual economic decision-making. The second is a political response to government action. The first can be referred to as economic salience and the second as political salience. As an aside, distinguishing between these two types of responses is very helpful in clearing up a recurring confusion about salience and taxes that is best illustrated by a VAT. A VAT is sometimes said to be quite salient.⁸⁵ That is because it will elicit a larger effect on consumers' consumption decisions.⁸⁶ If a price is VAT-inclusive, then consumers are likely to reduce demand for a product subject to the VAT. By contrast, if the price is tax exclusive (like many retail sales taxes), then consumption decisions should be affected less. Thus a VAT is salient in the sense of visibility affecting economic behavior. But a VAT is sometimes said to be less salient (than, for example, retail sales taxes).⁸⁷

⁸³ Some commentators directly reject the possibility. McCaffery, note 31, at 1931, 1943 (calling them “tricks” and the approach “fraught with dangers” and “runs afoul of basic moral notions” and stating “I must confess . . . to being uneasy at the prospect of exploiting cognitive error as a general approach.”); Leo P. Martinez, “Tax Legislation and Democratic Discourse: The Rhetoric of Revenue and Politics,” 4 Nev. L. J. 510, 516 (2003) (“the resort to taxes that are not on the public’s radar screen . . . can only delay what will inevitably be a rebellion against these heretofore ‘silent taxes’”). Others use terminology that makes it clear that they think it is a bad idea. See, e.g., Congdon et al, note 30, at 6 (raising the possibility that policymakers could affect welfare outcomes by “deliberately manipulating tax salience”); Ted Gayer, Behavioral Economics and the Conservative Critique of VAT, TaxVox Blog, Oct. 28, 2009, available at http://taxvox.taxpolicycenter.org/blog/_archives/2009/10/28/4364151.html (“the risk is that policymakers will use these insights [of behavioral economics] to deliberately temper healthy economic and political constraints on the growth of government”). Slemrod & Krishna, note 54, at 198-99, raise the normative issue but do not clearly take a position.

Generally, commentators also assume that increased salience is beneficial. See, e.g., Susan Cleary Morse, Using Salience and Influence to Narrow the Tax Gap, *Loyola Chi. L. Rev.* 483, 500 (2009) (offering proposals to make communications from the IRS more salient (i.e. relevant, prominent and accessible) to close the tax gap).

⁸⁴ For other suggestions that it might be acceptable to deliberately employ low-salience taxes, see Galle, note 30, at [n. 179] (“...we might employ hidden taxes only at the federal level. Using only national-level hidden taxes would thus avoid a number of the allocational distortions...”); Bob Williams, “The Benefits of Opacity,” Tax Vox Blog, May 26, 2009, available at http://taxvox.taxpolicycenter.org/blog/_archives/2009/5/28/4202956.html (suggesting that masking taxes may help to raise revenue in a relatively efficient way); Steven M. Sheffrin, What Does the Public Believe About Tax Fairness, 45 *Nat’l Tax J.* 301, 306 (1993) (“there may be scope for using their characteristic biases in the name of good tax policy”).

⁸⁵ See, e.g., Richard M. Bird, “Visibility and Accountability: Is Tax-Inclusive Pricing a Good Thing?,” *Can. Tax J.* [7-8] (forthcoming 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1529145.

⁸⁶ That is because consumers will base their consumption decision on the total sales price. The European Union, for example, requires that prices be tax-inclusive. See Council Directive 98/6/EC, art. 2, 1998 O.J. (L 80) 27.

⁸⁷ See, e.g., Post from Tony Cookson on This Young Economist Blog (Nov. 4, 2009), available at <http://blog.thisyoungeconomist.com/2009/11/should-government-hide-its-taxes.html> (“a value added tax (essentially a consumption tax that requires no math at transaction time) is less salient” than a retail sales tax).

That is because if the tax is built into the price, it is less obvious and voters will notice it less, producing a smaller political response.

The first type of response to salience would arise because the income tax imposes an economic burden on the payor, which would affect the amount of labor supplied as well as investment decisions. Taxes impose distortionary costs that change the decisions made by individuals due to price adjustments. That affects consumption decisions, which would be based on perceived after-tax income. It seems safe to assume that a highly salient tax would increase taxpayer response and a low salient tax would decrease response. Assuming the government was interested in decreasing distortions caused by the tax, then salience should be a concern. One possible reason to support the intentional use of low-salience tax provisions is that they may be efficient. Usually the behavioral changes reduce the efficiency with which resources are used, decrease output, and reduce utility. It is often suggested that efficiency costs can be reduced by imposing taxes on elastic goods or behavior because price is less important or irrelevant. If individuals are unaware of or ignore low-salience taxes and thus they operate in the same way as a tax on highly inelastic behavior, they might be relatively efficient because they would not affect the behavior of actors.⁸⁸ Under this view low-salience taxes might be said to promote efficiency.

On the other hand, distortions created by taxes may be magnified with low-salience taxes because taxpayers will not make labor or investment decisions with correct information. If individuals are confused about taxes, there may be no efficiency advantage. For example, if individuals were not sure there was a tax, they might act as if a tax was imposed whether there was a tax or not. If consumers were unaware of the tax, they would incorrectly calculate prices and thus might consume more of the goods subject to tax. With a binding budget constraint, they would consume less of other goods, thus distorting choice.⁸⁹ If consumers were unable to calculate the amount of the tax, they might assume a larger or smaller price adjustment than actually occurs. As noted above, almost all consumers will be aware of the income tax so the possibility that there are efficiency gains because of ignorance of the tax itself does not hold. It is certainly possible, however, that they cannot correctly calculate their income tax burden. Because we do not know whether taxpayers will under-estimate or over-estimate the tax, it is impossible to say for sure whether there would be efficiency gains or losses. If individuals

James Pethokoukis, VAT Attack! Another Reason it Is a Bad Idea (Oct. 28, 2009, 14:36), available at <http://blogs.reuters.com/james-pethokoukis/2009/10/28/vat-attack-another-reason-it-is-a-bad-idea/> (“the hidden nature of a VAT”).

⁸⁸ Galle suggests but does not wholly support the idea that such taxes may be a desirable feature of a tax system because they are efficient. His specific policy prescription is that “hidden” taxes are likely to be welfare-increasing for inelastically-demanded goods and welfare losses that result from transfers from poorer consumers to richer produces can be minimized by using hidden taxes in markets where those who benefit from a hidden tax are no wealthier than those who might lose welfare. Galle, note 30, at . See also Nussim, note 30 (also discussing efficiency perspective).

⁸⁹ See Congdon, Kling & Mullainathan, note 30, at 8. They note that taxes that are hidden from taxpayers will keep elasticity low; if there is a binding budget constraint, spending more on the item with the low-salience tax leaves less income for other purchases and thus distorts consumption and decreases welfare. They conclude that the net consequences are not clear.

assume that they owe more in taxes than they do (because, for example, they incorrectly assume that the marginal rate applies to every dollar earned or because they assume they are in the top (salient) bracket when they are not), they may under-supply labor. Under this view, if decreasing distortion with respect to taxes is desirable, salience is required. Conversely, there may be efficiency benefits to be gained where individuals are unaware of their marginal tax rates and instead use average rates.⁹⁰ Because average rates are less than marginal rates, individuals would supply more labor than they would if confronted with the actual marginal rate, decreasing excess burden.

Any argument with respect to efficiency is made less robust because each of these two offsetting possibilities is made more difficult to assess because of the complexity of the income tax, which makes taxpayer response more difficult to predict. Since the efficiency effects of a low-salience tax are not certain, this paper does not rely on efficiency gains to support the exploitation of salience as a fiscal policy tool.

The second type of behavioral response relies on political salience. This is the political reaction from the electorate in response to the adoption of a tax provision—it might range from outrage to full support, or importantly, perhaps no response at all. The political response to various tax provisions should vary with their salience.⁹¹ We would expect a more sustained political response to a salient tax or provision, either in support or protest.⁹² Conversely, there would be less response to a low-salience provision and perhaps no response at all. As contrasted with economic decisionmaking, this response is directed at legislators and is intended to affect tax policy, for example, the viability of a tax provision. It is assumed that legislators will react to an anticipated or actual political response.⁹³ Thus, a government that was interested in increasing

⁹⁰ The authors of two papers that assert that many individuals make economic decisions based on average rather than marginal tax rates both make the claim that this may improve welfare. Because average rates are less than marginal rates, individuals supply more labor than they would if confronted with the actual marginal rate, decreasing excess burden. Liebman & Zeckhauser, note 66; de Bartolome, note 67. De Bartolome appears to support the use of the misperception. *Id.* at 94 (“Maintaining the misperception is good public policy.”) See also Naomi Feldman & Peter Katuscak, *Should the Average Tax Rate Be Marginalized?* (CERGE-EI Working Paper No. 304, September 2006), available at <http://home.cerge-ei.cz/Peter/> (noting welfare gains from misperception of rates)

⁹¹ Although that is what is expected, it is not entirely clear that citizens will protest salient taxes and accept less visible taxes. It is common in the literature to assert that the more visible the tax, the more likely it is that it will be the subject of a protest. But the empirical data seems to indicate that other factors may predominate. Issac Martin & Nadav Gabay, “Do Visible Taxes Cause Protest? Tax Policy and Tax Protest in Rich Democracies,” available at <http://www.mediafire.com/?zrcjoy6hbam>.

⁹² See Bird, note 85, at 5 (“from a political perspective, people tend to react primarily to the taxes of which they are most aware”); Sausgruber & Tyran, note 53 (finding in a laboratory experiment that salience affects bias voting on commodity taxes).

⁹³ The Canadian experience with the introduction of a highly visible Goods and Services Tax, which replaced a much less visible federal sales tax, is instructive. The low initial rate was reduced twice after adoption due to the hue and cry that accompanied the GST. This was attributed to its visibility and the fact that retailers refused to accept a tax-inclusive pricing option. For the history, see Bird, note 85, at 6-9; for somewhat similar stories in other countries, see Richard Eccleston, *Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia* (2007).

taxes (or revenue) in an environment where that was politically challenging could exploit the availability bias by consciously adopting a low-salience tax provision. As another example, a political party that wanted to highlight a tax increase proposed by the other party would favor framing it in a salient way so that its prominence would attract attention and perhaps opposition.

Rather than rely on efficiency,⁹⁴ this section makes the case for intentionally exploiting political salience. There are circumstances when Congress should take advantage of the cognitive bias created by salience as a fiscal tool for political economy reasons.⁹⁵ Assuming that the state has the power to levy taxes and an appropriate need for revenue, it is proper for it to choose a form that is most palatable to its citizens. In other words, both high- and low-salience taxes may serve other, more important, goals. This is an instrumentalist argument—exploiting the salience bias may achieve an important end.

There is a strong relationship between tax salience and political support for taxation. Salience clearly affects the politics of taxation. It is foolish and counterproductive to divorce taxation from politics. Accepting that the citizenry both wants public goods (and perhaps redistribution) and thus revenue must be raised and that they abhor taxation,⁹⁶ it is appropriate for the government to utilize fiscal tools that can accomplish the revenue goal with the least pain. While cynically we might presume that this will be only in the interest of legislators seeking re-election,⁹⁷ it also may be entirely beneficial to citizens seeking to avoid the psychic pain of paying taxes.⁹⁸

⁹⁴ It is of course possible that the efficiency advantages of low-salience taxes will coincide with the political economy advantages of such taxes.

⁹⁵ The argument is limited to legislation. Whether it is appropriate to take salience into account with respect to regulations involves different considerations and is beyond the scope of this paper.

⁹⁶ See text accompanying notes

⁹⁷ See Amotz Morag, *On Taxes and Inflation* 116 (1965) (suggesting that less-visible taxes are better on both psychological and economic grounds and that “an important factor in the realities of the limits of taxation are the psychic costs of paying tax, costs which politicians will heed because they are clearly relevant to the prospects of re-election”).

⁹⁸ Given the inevitability of taxation, taxpayers may *prefer* taxes that are less visible. A survey conducted in Canada after the adoption of the GST indicated that Canadians preferred to have the GST included in the price. See Richard M. Bird, *Where do We Go From Here? Alternatives to the GST* 13 (KPMG Centre for Government, 1994) (noting that “Canadians may not agree on how much they like the government, the tax structure, or the GST, but they agree they cannot stand to be reminded of the GST every time they make a purchase.”). The experience in Japan, which switched from optional tax-exclusive pricing to mandatory tax-inclusive pricing, also bears this out. Although an overwhelming majority of registrants initially opted for tax-exclusive pricing (thus quoting the tax separately, ultimately most shifted. See Hiromitsu Ishi, *The Japanese Tax System* 291 (3rd ed. 2001) (consumers preferred “. . . to pay the tax without noticing the tax burden “). In 2004 the Japanese government mandated tax-inclusive pricing. Kotaro Tsuru, “Significance of Showing Net Prices that Include Consumption Tax: With a View to Improving Business Productivity,” (Research Inst. of Econ., Trade and Industry, Feb. 7, 2004), available at [http://www.rieti.go.jp/en/columns/a\)1_0117.html](http://www.rieti.go.jp/en/columns/a)1_0117.html).

The limited literature on salience and the politics of taxation assumes that the benefit of taking salience into account runs entirely to legislators. The Finkelstein study, for example, indicates that politicians will be rewarded by adopting a less-salient tax and penalized for adopting a more salient tax. The so-called leviathan literature, discussed below, assumes that politicians are revenue-maximizing and interested solely in their own re-election. While it is entirely possible that politicians who favor low-salience taxes will be rewarded via re-election, I argue that there is an external benefit as well, i.e. a political acceptance of taxes by the populace. In fact, they may fail to reward or penalize politicians because they are ignorant of various tax provisions or because they intentionally ignore them.

This is not to suggest either that Congress should always adopt low-salience taxes or necessarily that a low-salience tax will be the most palatable to the populace. Rather the argument is that it is appropriate for Congress to take salience into account as a fiscal policy tool. Clearly the sole use of low-salience taxes or changes ultimately will backfire. Cumulatively, when they become large enough either tax aversion will kick in or taxpayers will act rationally and will take them into account.⁹⁹

Like other instrumentalist approaches, it incorporates a process value critical for democratic legitimacy.¹⁰⁰ It is important to note that this approach does not enshrine private advantage or private agendas. Whether the government should raise revenue and how much will be determined in the public sphere.

1. *Low-Salience Provisions*

Congress already uses a variety of low-salience provisions and there is some evidence that it has done so intentionally. Withholding on wages is a low-salience way of collecting taxes because wage earners do not make payments directly to the government and usually observe only net pay. It also utilizes several other cognitive biases, such as loss aversion¹⁰¹ and easing the burden of economic decisionmaking.¹⁰² On the other hand, observant wage holders may find the tax quite visible because there is evidence of the tax on every pay stub.¹⁰³

There also are a number of provisions that have the effect of masking rate increases and there is some evidence that they were adopted for that reason because directly raising rates was not politically possible. Two examples are the so-called Pep and Pease provisions. The 1990 Deficit

⁹⁹ See Galle, note 30 (“the rational model likely implies that hidden taxes cannot be a major component of government budgets”).

¹⁰⁰ See the next section.

¹⁰¹ Withholding may also take advantage of loss aversion. Since wage earners do not make payments to the government, they are likely to assume that the portion representing withheld taxes was not theirs.

¹⁰² Martin & Gabay, note 91, at 5.

¹⁰³ See Gary S. Becker & Casey B. Mulligan, “Deadweight Costs and the Size of Government,” 46 *J. L. & Econ.* 293 (2003).

Reduction Act, increased the effective tax rate on certain taxpayers, but it did not do so directly. Instead it reduced itemized deductions for high-income taxpayers. Section 68 reduces certain itemized deduction three cents for each \$1 of the amount of adjusted gross income that exceeds an applicable amount. For each dollar AGI increases, taxable income goes up by the dollar plus three cents of eliminated deductions. For those taxpayers with AGI exceeding the applicable amount, their effective tax rate is 1.03 times the statutory rate. For example, a taxpayer in the top 35% bracket tax rate is increased by slightly over 1% on the amount of additional income, for a total tax rate on that income of 36%. This is exactly the same as if Congress had raised the rates 1 percentage point. That of course would have been much simpler, but at the time it was also politically difficult to do. Thus, Congress intentionally raised the effective tax rate without raising the nominal rates.¹⁰⁴ The same thing is true of the personal exemption haircut.¹⁰⁵ The intention was to increase the effective tax rate on wealthier taxpayers without changing the top marginal rate.¹⁰⁶

An earlier example of this is found in the Tax Reform Act of 1986, which imposed a 5% surcharge on certain middle income taxpayers to phase out the benefits of lower brackets. This effectively created a higher bracket that for some taxpayers was wedged between the apparent top bracket (28%, 33%, 28%). Congress began the practice of asserting that the top marginal tax bracket was lower than it actually was. For example, the Joint Committee explanation of the bill noted that there would be only two brackets, 15% and 28%, failing to mention the 33% bracket created by the rate bubble.¹⁰⁷

On a broader level, all phase-outs can be seen as a form of adjusting marginal rates without actually changing the nominal rates. They serve another purpose as well. When Congress phases out or imposes caps on deductions, it is still able to assert that the deduction is alive and well even though it has become far less valuable. For example, limiting the deduction on business meals and entertainment to 50% of the cost¹⁰⁸ leaves the deduction in place but effectively raises the tax rate on all those who incur the costs. There is no change, however, in the marginal rate schedule.¹⁰⁹

The failure to index the rate brackets for inflation also has the effect of changing the top marginal rate for many taxpayers without making any changes in the rate brackets, assuming

¹⁰⁴ Steuerle & Sullivan, note 30, at 407.

¹⁰⁵ IRC § 152(d)(3).

¹⁰⁶ Steuerle & Sullivan, note 30, at 407 (“In reality, it was designed mainly to increase tax rates—but without the increase being so obvious as to be reflected in the formal rate schedule.”).

¹⁰⁷ Staff of the Jt. Comm. on Tax’n, General Explanation of the Tax Reform Act of 1986, at 20-21 (Comm. Print 1987).

¹⁰⁸ IRC § 162(n).

¹⁰⁹ These “backdoor” ways of increasing tax rates have been subject to withering criticism. See 1999 ABA Section of Taxation Policy (advocating repeal and advocacy of explicit rate adjustments as a more transparent approach); also other statement (stealth rate tax increases); McCaffery, note 31, at 1900-01.

income increases with inflation. In periods of inflation, taxpayers will move up the rate brackets—and thus their taxes will increase—even though their purchasing power has remained steady.¹¹⁰ This tax “increase” has almost no salience at all because its source is not obvious. It takes a fairly savvy taxpayer to understand that an increase in inflation will have this effect. And perhaps more importantly it is not directly traceable to Congress—the failure to address inflation is not a specific act that is likely to become the focus of political debate. This remained true until the 1970’s when inflation became so insistent that there was a call to deal with what was referred to as inflation creep. The 1981 Tax Act indexed rate brackets but it was not fully implemented until 1989.¹¹¹ At that point the salience of inflation overpowered the low salience of inflation creep.

Another way to adjust the rates without doing so directly is to adjust downwards the income subject to a higher rate bracket. Even if a taxpayer does not change rate brackets, the extra income will be taxed at his marginal tax rate, increasing their effective tax.

Perhaps one of the most important ways Congress has devised to increase revenue indirectly is through the alternative minimum tax. The original purpose of the AMT was to insure that high income individuals paid at least some income tax and to increase the effective tax rate on high income individuals.¹¹² AMT is calculated by determining alternative minimum taxable income¹¹³ and reducing it by phased-out exemption amounts to calculate the taxable excess, on which the tax is levied.¹¹⁴ If the tentative minimum tax is greater than the regular tax, the taxpayer owes the difference.¹¹⁵ The AMT effectively has been used to obscure a taxpayer’s marginal tax rate and to permit Congress to raise marginal rates in a way that could not be done directly. Once the AMT is taken into account, actual marginal tax rates are no longer very salient due largely to complexity.¹¹⁶ Because of the interaction of the AMT with the regular tax rate schedule as well as the fact that the AMT base and regular base differ, it is difficult for

¹¹⁰ See McCaffery, note 31, at 1893-97.

¹¹¹ Add cite.

¹¹² Congress was apparently outraged by 154 individuals with incomes of over \$200,000, who paid no tax in 1966. H. Ways and Means Committee, Tax Reform Act of 1969, H. Rep. No. 91-413 (1969) *reprinted in* 1969 U.S.C.C.A.N. 1645. In addition, many individuals with high incomes were paying tax at a relatively low effective rate due to a variety of tax preferences, even to the point where the tax rates were regressive at the top end. Joint Comm. on Tax’n, 91st Cong., General Explanation of the Tax Reform Act of 1969 (Comm. Print 1969).

¹¹³ AMTI is calculated by adjusting income according to section 56 and section 58, and adding the tax preference items in section 57.

¹¹⁴ IRC § 55(a). The tentative minimum tax equals (1) 26% of taxable excess less than \$175,000, plus (2) 28% of taxable excess greater than \$175,000. IRC § 55(b).

¹¹⁵ IRC § 55(a). There are four current effective AMT rates (due to phase-out of the exemption), which are 26, 28, 32.5 and 35 percent. Once the phase-out range is passed, the marginal tax rate is 28 percent.

¹¹⁶ Williams, note 84 (noting that complexity causes a reduction in tax awareness and using the AMT as an example).

taxpayers to determine their actual marginal rate.¹¹⁷ It is likely that many taxpayers ignore the AMT calculus in making decisions in which they take their marginal tax rate into account.¹¹⁸ On the other hand the nominal marginal taxes rates are quite salient and a regular part of political discourse. In fact it is the highest rate that garners all the attention—virtually no attention is paid to the other rate brackets. Furthermore, the aversion to “raising taxes” almost entirely focuses on changes in the rate brackets, ignoring the possibility that other changes—such as adjustments to the base—are equivalent ways to raise taxes. Thus, what is salient is the top marginal rate. What also should be salient, but apparently is not, is an individual’s marginal rate. That is the rate, for example, that should be using in making investment or labor decisions. But there are two problems with this. Many taxpayers are confused about the difference between marginal rates and effective or average rates—even if they know in which rate bracket they fall, they mistakenly believe that all income is taxed at one rate. Or they may believe that all income is taxed at the average rate. The AMT further confuses this because it is difficult for individuals to calculate the highest marginal tax rate that or their own individual marginal tax rate. Thus, the focus is on the highest nominal tax rate.¹¹⁹

The low salience of the AMT does not occur because the tax is hidden or that people are unaware of it.¹²⁰ Politicians have done a good job of making people understand that it exists—largely through trumpeting their success in curbing its growth. But the details, and specifically, the effect on marginal tax rates, is almost completely ignored. It is the *effect* of the AMT, rather than the tax itself, that has low salience. Many people do not know if the AMT applies to them. But more important, even if they know that they may be subject to the AMT, they are unaware how it specifically affects their tax burden. For example, someone who is in the 24% marginal tax bracket may make economic decisions based on that rate even though the actual marginal rate may be higher due to the AMT.¹²¹ Thus, their behavior does not change in the way that it might if they were aware of their actual marginal rate and any revenue that the government might lose from changing the nominal rate brackets is retained.

¹¹⁷ See Linda M. Beale, *Congress Fiddles While Middle American Burns: Amending the AMT (And Regular Tax)*, 6 Fla. Tax Rev. 811, 824-25 (2004); Leonard E. Burman, William G. Gale & Jeffrey Rohaly, *The AMT: Projections and Problems*, Tax Notes 105, 105 (July 7, 2003) (both criticizing the AMT for this feature).

¹¹⁸ This is probably a good example of “schmeduling.” See Leibman & Zeckhauser, note 66. They argue that one of the conditions that gives rise to schmeduling is complexity and give schedule complexity as an example, by which they mean where there are multiple rates in the schedule or two or more schedules operate simultaneously. *Id.* at 4.

¹¹⁹ An added low-salience feature of the AMT is that it breaks the taxes into multiple pieces, making each piece less salient than the total.

¹²⁰ The “acceptance of the AMT” may be a result of multiple cognitive biases. For example, individuals may be unable to aggregate the regular tax with the AMT—partitioning the total tax bill into two parts may cause taxpayers to underestimate their actual tax burden. Anchoring bias may also do some of the work. Taxpayers are likely to anchor their estimate of tax burdens in the regular tax with its well-known marginal tax rates and be unable to adjust even when presented with additional information.

¹²¹ It is extremely difficult to determine the actual marginal rate in advance if the taxpayer is subject to the AMT. That is largely because of various phase-outs, such as the exemption amount. If the rate cannot be determined until the tax return is filed, it is the perceived marginal rate rather than the *actual* marginal rate that will affect behavior.

2. High-Salience Provisions

Conversely, there are circumstances where high-salience provisions may be warranted and it would be appropriate for Congress to take into account the fact that taxpayers will pay more attention to high-salience provisions than those with low salience. Low-salience taxes or provisions would be counter-productive with respect to Pigouvian taxes or tax incentives. In that case Congress wants to call attention to the benefit and to take advantage of an incentive, a taxpayer must be aware of it.¹²² Congress has designed certain provisions in the Code to be more prominent or salient. For example, at one time, the standard deduction and exemption were incorporated into a “zero bracket amount” that was built into the tax tables. Apparently many taxpayers believed that they had lost those tax benefits because they had been obscured in the calculation of taxes owed. Congress returned to the more highly salient presentation of those benefits by having taxpayers actually deduct the standard deduction and exemptions in calculating taxable income.

Where Congress provides tax incentives that are intended to affect behavior, it is important to take salience into account so as to increase both the number of taxpayers whose behavior is affected and the amount of the incentive utilized. In some cases it appears that Congress has intentionally attempted to design incentives in a manner that calls attention to them and in other cases it is not so obvious.¹²³ There are of course situations where it appears that Congress intended incentives but designed them in such a way that they are not very salient and are underutilized.¹²⁴

B. The Relationship Between Transparency, Complexity, and Salience

Transparency, complexity and salience are linked concepts. In the case of low-salience taxes, transparency and complexity concerns impose limits on the ability of legislators to exploit the salience bias. With respect to high-salience taxes, increasing transparency and limiting complexity are crucial to creating high salience.

Transparency in governance is generally a virtue and may appear that it complicates Congress’ ability to use low-salience taxes. But a lack of transparency in governance is not essential for the case for exploiting the salience bias and may even be counter-productive. The argument for using low-salience taxes is that they make raising revenue palatable to the citizenry—not that they should be tricked. If the goal is to obtain the acceptance of a tax, adopting it in the shadows is not likely to be nearly as effective as adopting it in the sunlight. Thus, a key to consent to the use

¹²² Congress could design an incentive provision to be of low-salience if they did not actually want to encourage use of the benefit or wanted to limit the revenue cost.

¹²³ Joel Slemrod, “Buenas Notches: Lines and Notches in Tax System Design,” unpublished paper, available at http://www.law.nyu.edu/ecm_dlv3/groups/public/@nyu_law_website__academics__colloquia__tax_policy/documents/documents/ecm_pro_065390.pdf (“It may be that notches get people’s attention in ways that smooth or kinked programs do not, so that they may be more effective in influencing behavior.”) Notches occur when an incremental change in income or expense causes a discrete change in income, deductions or credits.

¹²⁴ See, e.g., Deborah H. Schenk & Andrew J. Grossman, “The Failure of Tax Incentives for Education,” 61 Tax L. Rev. 440 (2008).

of low-salience provisions is the knowledge that they are not hidden and information about them can be obtained. While the parameters of salience are necessarily fuzzy, the fact that legislation is adopted in public view is necessary. What is not necessary, however, is that Congress explain that it is using a low-salience provision or why it is doing so, as long as it is possible to obtain the legislation and figure out its effect *if one wanted to do so*. For example, although there has been much academic complaint about the adoption of the Pep and Pease provisions because of a lack of transparency, they are a very good example of when using a low-salience provision may be desirable. If it was impossible for Congress to raise the marginal tax rates directly, using phase-outs may have accomplished the same thing in a politically viable way. For Congress to have explicitly announced that the effect was identical to raising the marginal rate would have defeated its purpose. However, so long as the provisions were adopted publicly and their effect could be understood (which it was), the transparency criterion is satisfied.

Complexity is more complicated. Increasing the complexity of a statutory provision is one significant way that legislators can decrease its salience. The statute itself can be quite complex, making it difficult to understand. Or the interaction of one provision with another provision can limit understanding. Or a taxpayer may have a choice between multiple credits or deductions that makes decisionmaking complicated. If increased salience is the goal—because Congress is adopting incentives or Pigouvian taxes—then complexity should be avoided because it will decrease the visibility or understanding of the provision and thus blunt its effectiveness.

If, however, the intention of legislators is to exploit the salience bias, then complexity will be a consideration. But it should not be the only consideration. As noted previously, it is possible to create taxes with low political salience that are not very complex—for example, a tax-inclusive VAT or the employer’s portion of Social Security. The use of too much complexity in order to limit salience, however, may backfire because it may raise political hackles simply because taxpayers cannot understand their obligations or may incur unacceptable costs to determine them.

V. Responding to Criticisms of Exploiting the Salience Bias

Almost all of the criticism directed against exploiting the salience bias relates to the intention use of *low*-salience taxes. This Section briefly reviews those arguments and concludes that none of them is strong enough to preclude a deliberate use of taking salience into account.

A. The Deliberate of Use of Low-Salience Tax Provisions Is Undemocratic

Intentional exploitation of cognitive errors—for example, ignoring non-salient information—might be said to fly in the face of democratic notions. It seems to show disrespect on the part of the legislature towards the people and exploits ignorance.¹²⁵ The result is that legislators fail to

¹²⁵ See McCaffery, note 31, at 1943; Bird, note 85, at 17 (noting in support of tax-exclusive prices rather than tax-inclusive prices, that “hiding the tax bill does not seem a particularly attractive way to build a sustainable democratic consensus in support of fiscal equilibrium”). Galle refers to it as “government by deception.” Galle, note 30 [n. 229]

act on voter preferences. This argument might be restated as follows: (1) The government has the power to raise revenue and the power to decide the exact form in which to do so. (2) The government understands that both Method A and Method B will raise \$X in revenue. (3) The government also believes that Method A is more politically viable because it is preferable to voters because it is less prominent and therefore less painful. (4) Nevertheless although the government could publicly choose to use Method A by passing legislation (thereby satisfying the transparency criterion), it would be undemocratic to do so.

There are a number of responses to this critique. Broadly this criticism is directed at any instrumentalist approach and taken to the extreme would prohibit the government from taking into account many means to accomplish legitimate government goals. But the essence of government is to weigh problems and the trade-offs of various approaches. The use of low-salience provisions is essentially a trade-off between benefits to be gained from government paternalism and the possible undemocratic nature of utilizing citizen ignorance or indifference.¹²⁶ If Congress believes that the current fiscal situation is a crisis that requires additional revenue, there is no reason that it cannot raise revenue in a way that the people find acceptable or more palatable.¹²⁷ Note that the use of low-salience taxes or tax provisions is predicated on some transparency in the legislative process. Because no tax is invisible or is adopted without mandated transparency, it is only the form that is low-salience.

The argument that relying on cognitive bias shows disrespect for the people must be taken to mean that the low-salience taxes (or for that matter high-salience taxes) do not reflect voter preferences. A second problem with the anti-democracy claim relates to the difficulty of discerning voter preferences and determining those preferences that should be taken into account. The claim focuses only on voter preferences with respect to taxes. Even assuming that we know what those preferences are (more on this below), it ignores voter preferences with respect to spending. It seems clear that voters want extensive government programs. Despite some rhetoric about “big government” and run-away spending programs, it is hard to find any support for cutting specific programs. Voters therefore are sending conflicting signals to their representatives: they want programs but they do not want to pay for them. Their preferences on taxes are clear only if we sever taxes from spending; their preferences on spending are clear only if we sever spending from taxes. But neither approach makes sense under democratic theory since spending and revenue are inevitably intertwined.¹²⁸ In order to carry out voter preferences, the government needs to know whether citizens are willing to pay \$X for a Program Y—

¹²⁶ There also may be a trade-off between distortions caused by citizens acting on incomplete information and, for example, making poor consumption choices, and the beneficial increases in revenue.

¹²⁷ It is possible that individuals actually prefer low-salience taxes—that there is a bias in favor of such taxes because they are less painful than taxes that are more visible. If so, any anti-democratic claim is less viable.

¹²⁸ The argument offered in this paper could apply to spending as well, only in reverse. Broadly stated, legislators might make certain spending extremely salient to create the impression that significant spending is directed at certain areas or projects. For example, Congress might make the absolute amount of spending for education highly prominent while obscuring the relative amount of spending. Or Congress might make the beneficiaries of spending less prominent in order to obscure their identity. Salience with respect to taxes and spending also can interact. For example, spending on Social Security—benefits paid to recipients is quite salient while the fact that in some cases Social Security payments are taxed is far less so. This creates an illusion about benefits.

something they do not know. It is impossible for legislators to ascertain whether “we want Program Y” or “we do not want to pay \$X in taxes” represents true preferences. It is not clear therefore that levying a low-salience tax or adopting a low-salience provision that produces \$X in revenue fails to carry out voter preferences. Suppose the government does not adopt the tax and instead cuts Program Y? Is that more democratic? Are we certain that carries out voter preferences? Another alternative is the current approach—retain Program Y but raise less than \$X in revenue. Ultimately, that may result in “bankruptcy” (as is practically the case for some states) or fiscal collapse. That too has enormous costs and it is certainly not clear that such a result represents voter preferences more than raising \$X in a more palatable way does. And it is worth noting that obtaining the necessary information—determining if voters are willing to pay the true cost of a specific program—is unrealistic at the federal level.

Finally, even limiting the claim to preferences with respect to taxes, determining voter preferences is challenging. Calculating citizen preferences with respect to voting is difficult enough; understanding voter preferences on policy issues is even more complex because those preferences are not always observable and thus a proxy must be used. Even in the case where policy issues are salient and part of a campaign, voting for a particular candidate may obscure voter choice. For example, suppose a candidate supports lower taxes, gun control, and abortion choice and wins the election. We cannot be sure that all those who voted for the candidate support lower taxes; some may have voted solely with respect to the candidate’s position on abortion and guns. And even if we knew that all those who supported the candidate because of her strong position on lower taxes does not tell us exactly how the electorate wants her to vote on the design of a tax system.

It is also possible that citizens prefer to be “fooled,” i.e. that their actual preference is for a low-salience tax or provision. It seems entirely possible that voters are aware of the need for revenue but have a high aversion to taxes and thus prefer the taxes to come in a form that is less unpleasant by being less noticeable. Otherwise, they may bear a cognitive cost—a form of tax aversion—by being confronted with the tax. Assume that the fiscal illusion, discussed below, is correct. That is, legislators are revenue-maximizing and will continually seek to raise non-salient taxes with as little attention as possible. And also assume, as discussed below, that over time taxpayers debias—that is, they come to understand that this is what legislators will do and expect them to do so.¹²⁹ It follows that if low-salience taxes persist, this approach must be the preference of voters,¹³⁰ meaning they prefer for revenue to be raised by low-salience taxes. There is some evidence of this with respect to Social Security taxes, where there seems to be a

¹²⁹ See Cabral & Hoxby, note 34 (“If a voter knows that politicians are revenue-maximizing and that they will attempt to raise taxes that are non-salient, a voter should suspect—in the absence of information—that politicians are continually increasing non-salient taxes to the extent possible without drawing attention to the increases. A sophisticated voter should assume that a politician has increased non-salient taxes unless he offers evidence to the contrary.”).

¹³⁰ It is also possible that if tax aversion is high enough, see , that voters would prefer high-salience taxes. Mitral and Hoxby argue that “A primary implication of our results is that a non-benevolent government will wish to decrease the salience of taxes and that voters facing a non-benevolent government will wish to keep taxes’ salience high—even if the forms of taxation that are highly salient cause inconvenience and animus such as that generated by the property tax.” Cabral & Hoxby, note 34.

preference for splitting the notional burden of the tax between employers and employees although the incidence falls on employees.¹³¹ If that is their preference, the democratic claim does not hold.

Another response to the anti-democratic critique is instrumental. Law is designed to encourage or incentivize certain behavior. In this case, the behavior to be encouraged is acceptance of taxes; the behavior to be changed is the extreme aversion to taxes. Taxes enable governmental policies and the form in which they are levied is a pragmatic tool used by the government to effectuate its ends.

Given the significant uncertainty about voter preferences and the need for government to use pragmatic tools, the argument that use of a low-salience tax is undemocratic in that it does not carry out voter choices is not very robust.

B. Low-Salience Taxes Will Make it Easier for Legislators to Adopt Higher Taxes

This fiscal illusion or leviathan claim, is traceable to Puviani¹³² and was emphasized in the modern literature by James Buchanan.¹³³ It is widely accepted that individuals will have imperfect information on which to base their decisions about government. The costs of obtaining this information are such that individuals are not likely to expend the resources to obtain accurate information. Buchanan and others hypothesize that citizens will systematically under-estimate the cost of public goods and activities and over-estimate the benefits provided and that the government will exploit this effect. The result will be a government that is larger than the citizenry would actually prefer—in other words larger, less-than-optimal governments. People will over-consume government services because they are unable to or unwilling to obtain the necessary information to estimate the costs correctly.¹³⁴

¹³¹ There are plenty of similar examples from the nontax world: cherry-flavored medicine and \$9.99 price tags are two that come to mind.

¹³² Amilcare Puviani, *Teoria della Illusione Finanziaria* (1903), partially translated and edited in J.M. Buchanan, *Public Finance in Democratic Process: Fiscal Institutions and Individual Choice* 135, 135 (1967). Puviani assumes that the government can manipulate taxes so that citizens will under-estimate their tax burden by, inter alia, tax-inclusive prices, disaggregation of the tax, and complex tax rules.

¹³³ James M. Buchanan, *The Fiscal Illusion*, in *Public Finance*, note 132; Geoffrey Brennan & James Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* 24-32, 40 (1980); see also Galle, note 30, at (“Low visibility may also present opportunities for self-serving tax increases by public officials, leading to inefficiently high tax rates.”) The idea can be traced back to John Stuart Mill, *Principles of Political Economy with Some of Their Applications to Social Philosophy* 237 (2004) (1871) (indirect taxes that are less visible than direct taxes affect government incentives).

¹³⁴ Sometimes this argument is framed as economic distortion. For example, Bird & Gendron, note 30, at 19, note that there is a “hidden political benefit” to a government that imposes a VAT because revenue comes from “taxes on business inputs and thus is hidden from the consumer.” They argue “[s]uch hidden taxes are economically distorting, but nonetheless they often appear to be more palatable politically than visible taxes imposed on final consumers.”

There are a number of reasons why critics argue that citizens will systematically under-estimate costs and the low-salience of a tax is one of them.¹³⁵ Under the leviathan hypothesis, if taxes are not easily visible, some taxpayers will free ride on the efforts of other taxpayers to reduce taxes or oppose increases.¹³⁶ Another claimed distortion is that voters who misperceive their tax burden may not choose the political representatives that they might choose if they had accurate information about their representative or about political candidates. Finally critics prefer high-salience taxes because they will impose a constraint on legislators, making it difficult for them to raise taxes.¹³⁷

There are several problems with this argument.¹³⁸ First, because low-salience taxes are only one fiscal tool the government may use, it is difficult to know whether the use of this tool standing alone will lead to a bigger government.¹³⁹ There might in fact be causality, but that is unknown. The results of empirical work on fiscal illusion generally are mixed and there is very little empirical evidence about the relationship between salience and the size of government.¹⁴⁰ That

¹³⁵ Others include complexity, the form in which the tax is extracted, the costs, and the lack of effect the citizen will have should he attempt to act on the information.

¹³⁶ Another somewhat analogous argument applies specifically to consumption taxes, which is that consumers should have “full, accurate, and clear information of the full sale prices of goods” so as to improve consumption choices. Confusion and over-consumption arguably decreases utility and social welfare. See Nussim, note 30, at 8, 11. With respect to income taxes, the choice is the amount of public goods and activities to “consume.”

¹³⁷ See, e.g., Ian Ayres, A Defense of Irrational Taxation, Freakonomics Blog, Oct. 28, 2009, available at (<http://freakonomics.blogs.nytimes.com/2009/10/28/a-defense-of-irrational-taxation>) (“. . . as matter of political economy, we might as a society want to keep our taxes highly salient (even if it increases the dead-weight loss of taxes) to make sure that our representatives feel more constrained when deciding whether or not to hike our rates 20 to 40 percent.”); Cookson, Blog post, note 87 (“I am not sure we should give our government officials another incentive to raise taxes.”). This is closely related to the “money machine” argument that is usually raised in connection with adoption of a VAT. There is some evidence that VAT rates increase over time because they are tax-inclusive and thus less visible. See Michael Keen & Ben Lockwood, “Is the VAT a Money Machine?” 49 *Nat’l Tax J.* 905 (2006).

¹³⁸ Galle notes that low tax salience would interfere with mechanisms used to constrain the ability of a government to restrain taxes. Specifically, under leviathan government theories, there is a competition between governments for mobile taxpayers that limits the rate at which tax increases could occur. Galle, note 30, at . This argument is quite weak in the federal setting since taxpayer mobility is quite low (i.e. leaving the country) and for individual taxpayers, at least, there is little tax competition at the federal level. See *id.* [n. 179]

¹³⁹ Becker & Mulligan, note 103 (discussing factors that might affect the size of government).

¹⁴⁰ See Brian E. Dollery & Andrew C. Worthington, “The Empirical Analysis of Fiscal Illusion,” 10 *J. Econ. Surveys* 261, 264 (1996) (surveying literature and concluding results are mixed); Norman Gemmill, Oliver Morrissey & Abuzer Pinar, “Taxation, Fiscal Illusion and the Demand for Government Expenditures in the UK: A Time-Series Analysis,” 15 *Eur. J. Pol. Econ.* 678 (1999) (reviewing studies); Libor Dusek, Are Efficient Taxes Responsible for Big Government? Evidence from Tax Withholding,” available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1585119 (withholding accounts for some but not all of government growth in post-war United States); for earlier work, see Wallace E. Oates, “On the Nature and Measurement of Fiscal Illusion: A Survey,” in *Taxation and Fiscal Federalism: Essays in Honour of Russell Mathews* (G. Brennan, B. S. Grewel & P. Groenwegen eds. 1988) (surveying the literature and finding no persuasive connection between salience and government size).

may be because of the difficulty in determining taxpayer perceptions about the price of public outputs. A citizen's perception of price will vary with the means used to extract the funds for government services. The more complex the system, the more difficult it will be for a citizen to form a perception. And as already noted, the more salient the information or the tax provision, the easier it will be to obtain necessary data. It also may be because special interests are at work that counteract any effect from salience.¹⁴¹

Second, this argument is based on the premise that citizens *under-estimate* their taxes (and thus receive more government than they perceive to be optimal).¹⁴² And most studies assume that individuals will under-value low-salience taxes, i.e. even if they are aware of the tax, they will assume that the amount of the tax is less than it is (zero if they are unaware of the tax).¹⁴³ But it is also possible that citizens will misperceive the tax burden in the other direction; that is, they will over-estimate their tax burden (or estimate their burden correctly). We do not have conclusive empirical evidence that voters systematically under-estimate their tax burden and there is some reason to believe that they may actually over-estimate.¹⁴⁴ If individuals are aware of the tax, they may take shortcuts in estimating the tax that will result in over-valuation. This might occur because they will round up a tax-exclusive price. For example, the current sales tax rate on purchases in New York City is 8.875%. Those who actually take the sales tax into account often do not go to the trouble of actually calculating the correct amount of tax but

McCaffery conjectures that one reason that Social Security taxes have grown over time is the fact that the burden of the employer's share of the tax falls on the employee but this is hidden and therefore this method of raising revenue is attractive to Congress. McCaffery, note 31, at 1878-80. A recent cross-country study, however, concludes that countries that collect more of the tax from employees (more salient collection) do not spend less on public pensions than do countries that collect more from employers (less salient). Casey B. Mulligan, Ricard Gil & Xavier X Sala-i-Martin, "Social Security and Democracy," 10 B.E. J. of Econ. Analysis & Pol'y: Iss. 1 (Contributions), Art. 18. (2010), available at <http://www.bepress.com/bejeap/vol10/iss1/art18/>.

¹⁴¹ Casey B. Mulligan, "Don't Fear the Invisible Tax," N.Y. Times Economix Blog (Apr. 21, 2010), available at <http://economix.blogs.nytimes.com/2010/04/21/dont-fear-the-invisible-tax/#more-61479> ("I am not especially surprised that tax visibility is empirically unrelated to the amount of taxation and government spending, because the impressions of voters who see the more visible taxes are by no means the only determinant of government spending. Special interests matter too.").

¹⁴² When we make assumptions about citizens' perception of taxes, we probably make an assumption about the median citizen since politicians try to appeal to the median voter. Thus, we might say that we get the "correct" level of government if it is the level of government that we would get with a representative democracy, meaning that it would be like the one that incorporated the desires of the median voter.

¹⁴³ See note 73 for a discussion of cognitive biases that might lead to undervaluation of taxes.

¹⁴⁴ In the Finkelstein study, EZ Pass users over-estimated their tolls rather than underestimated them. Finkelstein, note 46. This makes it more difficult to argue that it is easier for the government to raise tolls or rates because taxpayers may believe that they are higher than they already are. In the Mitral and Hoxby study, homeowners using the tax escrow method of paying property taxes did not systematically under-estimate their taxes. Hoxby, note 34; see also Norman Gemmill, Oliver Morrissey & Abuzer Pinar, "Tax Perceptions and Preferences over Tax Structures in the United Kingdom," 114 Econ. J. 117 (2004) (empirical study showing that British taxpayers systematically over-estimated income tax and VAT liabilities); Nussim, note 30, at 12 (arguing that in the case of commodities, consumers, facing uncertainty, will not necessarily under-value prices);

routinely round up to add an extra 10% to purchases.¹⁴⁵ Others may be confused about exemptions and may assume that the tax applies to all purchases.

With respect to income taxes, even if we assume that taxpayers will not correctly calculate their tax burden, it is difficult to know whether they will under-estimate or over-estimate the burden. For example, some citizens may believe that everyone is subject to the top marginal rate or that everyone is subject to the estate tax. Some may confuse the tax burden with withholding. Many are not able to accurately determine their marginal tax rate.¹⁴⁶ Citizens may also ignore some taxes (that are not salient) and concentrate only on those that are prominent. They may also fail to take into account government benefits received that should be offset against the tax. If that is so, then it is possible that we may in fact end up with the optimal taxes and the optimal government, based on voter preferences. It is also possible that the populace may systematically assume that there is a low-salience tax that they either cannot uncover or do not want to attempt to uncover. Since they do not have details about the tax, they may add some additional amount to the burden they can calculate.

Assume for example, that voters are willing to elect those who would impose a 30% tax. Suppose that voters believe that elected officials are always going to impose a 10% low-salience tax—they just are not able to spot it. As a result, they elect officials who are committed to 20% high-salience or visible taxes. Although both voters and officials might prefer visible 30% taxes, they cannot achieve that so long as voters believe that officials will add a low-salience 10% tax. Thus, any attempt to impose higher visible taxes will be met with defeat because voters will believe that this will result in a tax burden higher than 30%. In this case, we end up with a second-best solution that produces the right result, i.e. a 20% visible tax and a 10% less-visible tax that funds the level of government desired by the voters. That case eliminates an anti-democratic critique because it embodies voter preferences, that is, citizens obtain exactly the level of government that they want.¹⁴⁷

Now assume that voters believe that the total taxes imposed are 40%, when they prefer 30%. If in fact the taxes are 30%, there is a problem only if they turn the elected officials out of office based on false information. Otherwise, citizens still have their preferences carried out. Finally assume that voters believe that there is a 15% low-salience tax (that they cannot identify) and therefore they pressure officials to keep high-salience taxes quite low, say 15%. (This might occur because taxpayers are so mistrustful of government that they assume that it will impose a high low-salience tax.) If the low-salience taxes are actually 10%, citizens receive less

¹⁴⁵ There may actually be two errors. Suppose for example that the item costs \$89. The consumer may estimate the tax as \$8.90 (10%) and then may add \$9 to the price (rounding) to get \$98 or may take 10% of \$90 (easy to calculate) to get \$99. In either case, the actual tax-inclusive price is \$96.89.

¹⁴⁶ See, e.g., Steven Sheffrin, “Perceptions of Fairness in the Crucible of Tax Policy,” in *Tax Progressivity and Income Inequality* 309 (Joel Slemrod ed., 1994) (reviewing the literature on this point).

¹⁴⁷ Broadly stated, this is similar to the agency-principal story in corporate governance. Assume it is desirable to pay a fixed amount of compensation to managers. Since we know they would shirk, we might engage in monitoring or incentive compensation although each imposes additional costs. Given shirking, however, the best mix of compensation is one that would otherwise be second-best. Similarly, while it would be better to impose only high-salience taxes, if the populace believes that there might be low-salience provisions, a mix is a second-best solution.

government than they prefer. But note, under this scenario the leviathan argument does not hold—citizens do not have *more* government than they prefer. The conclusion is that if taxpayers over-estimate their tax burden, they are extremely unlikely to receive more government than they prefer.

To the extent, however, citizens under-estimate their tax burden, it may be possible for the government to impose a higher rate of tax—and thus a higher level of government—that does not correspond to citizen preferences. Thus, suppose that citizens believe that total taxes imposed are only 20% when actual taxes are 30%. This may be because they are unable to accurately assess tax rates or because they believe this because they are unaware of a 10% low-salience tax. This creates an opportunity for the government to propose a 10% tax increase without opposition because taxpayers will believe that it will fund a government at their preferred 30% level. And that would produce a larger government than voters prefer. But this would be true only if voters systematically under-estimated their taxes—a fact that has not been proven.

It is possible that there is a subset of voters who prefer higher taxes, perhaps because they favor goods and services provided by a large government or perhaps because they favor significant redistribution. Hiding taxes does nothing to win the support of those voters. While this might seem to defeat the use of low-salience taxes, such taxpayers would appear to be the exception rather than the rule.

C. Debiasing

A third objection to the use of low-salience tax provisions is based on the possibility of debiasing. An individual who incurs an economic cost as a result of a bias (for example ignorance or intentionally ignoring the tax) has an incentive to debias himself—that is to obtain or stop ignoring information about the tax provision. Given that low-salience taxes are not actually hidden, such individuals have a good source of information. If individuals routinely debiased, then the use of low-salience taxes as a fiscal policy tool would produce a short-term advantage at best.

This critique is valid only to the extent we believe that debiasing would actually occur. But there are several reasons to believe that debiasing is not likely. First taxpayers have to be aware that they are making a cognitive error—this depends on feedback, which might come from other taxpayers or perhaps from politicians. If the feedback is to come from other taxpayers, then there must be some group that does not ignore low-salience provisions and understands their effect. That is mostly like to be experts or perhaps high-income taxpayers who bear a larger tax burden. Experts will probably have little effect unless they grab the imagination of the general populace and high income taxpayers do not have much incentive to provide feedback to others who fail to take tax low-salience taxes into account. While it is theoretically possible for one political group to provide information to voters in order to gain some political advantage, at the federal level that seems implausible because, for example, both parties benefit from the increased revenue flowing from low-salience taxes.

Generally individuals shed themselves of cognitive bias through education. But acquiring and understanding information about public finance and various taxes is problematic and costly. The details of taxation are inordinately complex, and most would say, quite boring and incomprehensible. It would take a significant, time-consuming campaign to educate individuals sufficiently about taxation that they would focus on less prominent taxes or tax provisions. And the pay-off is quite low. For most citizens the change in taxes levied would be quite small. There is a further problem in how debiased citizens express their new found dislike of low-salience taxes. The most obvious way is a vote in a congressional election but this issue is likely to be swamped by other more salient and pressing issues.¹⁴⁸ Finally low-salience taxes are not invisible and information about them is available. If taxpayers are choosing to ignore such taxes, that may reflect their preference. If so, they may not have an incentive to de-bias.

For all these reasons, the likelihood of debiasing is quite low and thus the argument that the use of low-salience taxes would be ineffective is not convincing.

D. Distributional Concerns

Another potential problem is that low-salience taxes may be regressive.¹⁴⁹ Taxpayers who are simply ignorant of a tax (or a tax feature) may be lower income either because wealthier individuals are better educated or can pay for someone to look out for their interests. Thus it is less likely that a tax provision would completely escape the notice of a well-to-do individual. Assume for the sake of argument that high-income individuals are less likely to ignore low-salience taxes. Therefore legislators may find low-salience taxes more effective with low-income individuals than high-income individuals. Is the distributional concern that Congress will fool only low-income taxpayers? Or is the concern that low-income taxpayers will bear a larger-than-desirable tax burden? If the latter, it is not clear that this is true. For example, Social Security, viewed as a low-salience tax because its incidence is not understood, is indeed regressive. But other low-salience income tax provisions like the AMT and the Pep and Pease provisions are targeted at high-income taxpayers.

On the other hand, high income individuals are more likely to ignore a tax (even if it is known) because the disutility of computing a tax is larger than the subjective present value of the tax. In that case low-salience taxes may actually affect high income taxpayers more than low income taxpayers. One reason this might be so is because high income taxpayers have higher opportunity costs. This is particularly likely to be true with commodity taxes but less likely to be true with a broad-based tax where the present value of the tax would have to be quite low to be less than the disutility of calculating the tax. As compared to commodity taxes, the income tax would (or could be) significant and furthermore the disutility of making calculations would decrease with wealth.

¹⁴⁸ For the problems with debiasing, see Galle, note 30 at; McCaffery & Baron, Redistribution, note 7, at 1785-86. The latter's experiments showed little effect from individual education.

¹⁴⁹ Galle, note 30, at

Another potential distributional concern is that the income tax (or the entire tax system) will be less progressive (or regressive) than citizens actually prefer. If a tax is ignored, citizens will be unaware of or fail to take into account, its characteristics, including the degree of progressivity. For example, most voters would be unaware of the degree of redistribution attributable to the corporate tax because of its low salience and thus would have a misperception about the extent of progressivity in the system.¹⁵⁰

On the hand, low-salience taxes may increase progressivity in a way that is political acceptable. One could imagine that a direct monetary transfer from the wealthy to the poor might not be palatable even to those who favored a good deal of redistribution but the same thing accomplished via phase-outs or the AMT might be acceptable. Of course, it is possible that low-salience taxes could result in too much redistribution, meaning that there is more distribution than citizens in the abstract would choose. Because the redistribution is not visible, they would not object.

In sum, there are three possibilities: low-salience taxes may result in less redistribution than citizens prefer, more redistribution than they prefer, or help to achieve politically the preferred distribution. Without more empirical work, it is difficult to be sure which predominates.

E. Ineptness

Another concern is legislators will not be able to use a cognitive bias carefully in designing a tax or provision. If they are not able to do this well, then perhaps it would be better if they did not do it at all. Closely related to this critique is the charge that exploiting saliency will not work. The chief impediment to using saliency as a fiscal tool is that anti-tax forces will expose the low-salience provision.

But that may not matter. There are numerous examples of low-salience provisions that currently exist that have been exposed to sunlight and yet Congress retains them. That may be because it is only the cognoscenti who recognize their effect; average taxpayers are either unaware of them or their consequences. They may continue to exist because everyone wants them to exist—both Congress and taxpayers recognize the need for taxes and prefer them in this form—Congress because they are less likely to be punished and taxpayers because low-salience taxes are less painful.

VI. An Example of Appropriate Use

This section lays out a specific example of when it would be appropriate for Congress to exploit the salience bias. When the politics of taxation are such that it is impossible for Congress to raise tax rates directly and additional revenue is warranted, it is appropriate for Congress to intentionally adopt low-salience features of an income tax. This Section briefly explores the current political economy of tax legislation that makes the straightforward adoption of tax legislation—particularly changes in tax rates and increases in tax revenues—extremely difficult

¹⁵⁰ This potential equity problem could be due to other cognitive biases as well as salience. See McCaffery & Baron, *Redistribution*, note 7, at 1781-82.

even in a period of high (and rising) deficits. Taxes with low salience are one useful fiscal tool for overcoming these political economy problems. I suggest that low-salience tax provisions may be a way to get past the “no new taxes” rhetoric that has plagued public discourse about taxes for the last several decades and that ultimately has hamstrung Congress. There are three components of this argument: tax aversion, budget deficits, and the politics of taxation.

A. Tax Aversion

The political economy story depends in part on the public’s dislike of taxes. A growing literature has considered the concept of “tax aversion,” as something distinct from loss aversion.¹⁵¹ The notion is that the disutility of paying taxes is greater than that from other types of losses.¹⁵² The core idea is that calling something a tax rather than something else (for example, a fee or mandated payment) creates a negative reaction.¹⁵³ While most of the work has focused on how this might increase tax avoidance and evasion,¹⁵⁴ and therefore affect compliance, this disutility likely also manifests itself by affecting Congress’ ability to raise revenue. Thus we start from the proposition that although citizens desire the public goods (and perhaps redistribution) provided by the government, it will be difficult to extract the revenue needed to pay for public goods.

B. The Budget Crisis

A second component of the instrumentalist argument is that Congress needs to raise revenue. The unsustainable trajectory of the U.S. budget is well known.¹⁵⁵ Federal debt held by the public

¹⁵¹ McCaffery, note 31, at 1878 (defining it as “a phenomenon . . . akin to but distinct from loss aversion, whereby individuals attach disproportionate disutility to government extractions perceived or labeled as ‘taxes’”).

¹⁵² See Fennell & Fennell, note 7, at 79 (defining one kind of tax aversion as the amount by which one’s aversion to a tax exceeds the economic cost of the tax). It is not hard to locate undocumented statements that Americans hate taxes—it’s a given requiring no support. See, e.g., Joshua D. Rosenberg, “The Psychology of Taxes: Why They Drive Us Crazy and How We Can Make Them Sane,” 16 *Va. Tax Rev.* 155, 15-58 (1996) (“Most working Americans would readily acknowledge that taxes drive them crazy. . . [O]nly tax laws seem capable of engendering nearly universal anger, anxiety, paranoia and outright hatred, as well as substantial noncompliance. . . . For most Americans, any tax is a bad tax...” (no footnotes omitted)); McCaffery & Baron, *Isolation*, note 30, at 289 (“People do not like to pay taxes.”).

¹⁵³ McCaffery & Baron, *Thinking*, note 74, at 117-18 (finding that labeling something as a tax is likely to make it less preferable than, for example, labeling it as a fee). Baron and McCaffery conducted a number of experiments in which subjects evaluated payment mechanisms for various government programs. They found that labels matters and the subjects reacted differently to taxes, generally negatively. McCaffery & Baron, *Redistribution*, note 7, at 1759-61. In another experiment, Eckel, Grossman, and Johnston also found that reactions were different to a payment labeled as a tax as compared to an unlabeled payment. Participants who were told that the sum of money they had been given had been subject to tax tended to reduce their voluntary contributions to charity to offset the tax. Catherine C. Eckel et al., “An Experimental Test of the Crowding Out Hypothesis,” 89 *J. Pub. Econ.* 1543 (2005).

¹⁵⁴ See, e.g., *id.*

¹⁵⁵ See, e.g., Peter R. Orszag, Dir. of the Cong. Budget Office, Statement before the U.S. S. Comm. on Fin.: The Long-Term Budget Outlook and Options for Slowing the Growth of Health Care Costs (June 17, 2008), *available at* http://www.cbo.gov/ftpdocs/93xx/doc9385/06-17-LTBO_Testimony.pdf (describing the future of the U.S. budget and its unsustainability).

is on track to surpass its previous highest level 109 % of GDP by 2025 and to rise rapidly in future years.¹⁵⁶ The General Accounting Office predicts that Social Security, Medicare, and Medicaid expenditures will constitute 65% of federal expenditures other than interest in 2030.¹⁵⁷ If current law remains in force, in thirty years, government revenues are expected to meet one-half of all expected expenditures.¹⁵⁸ It is widely agreed that this is a crisis that eventually cannot be ignored. Growing budget deficits will result in rising interest rates that discourage investment in the United States and ultimately will cause economic disruptions.¹⁵⁹ It is also understood that there are only two solutions: cutting spending and raising revenue. To date, despite rhetoric about the need to cut spending programs, neither Congress nor the public has shown much taste for doing so. Cutting “government waste” would make only a small dent in the problem; large scale cuts in Social Security and Medicare would be required and that is politically implausible. Thus the United States faces the need for significant additional revenue that must be raised from a populace with an aversion to taxes.

C. Political Rhetoric and the Impossibility of Raising Taxes Directly

Congress has altered the rate structure of the income tax in the past, usually when substantial amounts of additional revenue were needed, often in ways that are direct and salient.¹⁶⁰ But in the last several decades Congress has found it difficult to increase rates or to expand the base in a prominent way. Indeed the public’s aversion to taxes has been exploited so much that it has become almost impossible to raise taxes directly. There are several reasons for this, which I briefly catalogue here.

¹⁵⁶ U.S. Gen. Accounting Office, *The Federal Government’s Long Term Fiscal Outlook*, Jan. 2010 Update 1 (2010), available at <http://www.gao.gov/new.items/d10468sp.pdf>.

¹⁵⁷ *Id.*

¹⁵⁸ FIN. MGMT. SERV., U.S. TREASURY DEP’T, *FINANCIAL REPORT OF THE U.S. GOVERNMENT, 2009, MANAGEMENT’S DISCUSSION AND ANALYSIS 9* (2009), available at <http://www.gao.gov/financial/fy2009/09mda.pdf>.

¹⁵⁹ *See, e.g.*, Alan Greenspan, *Testimony before the Joint Econ. Comm. of the U.S. Congress: Economic Outlook* (Nov. 3, 2005) available at <http://www.federalreserve.gov/BOARDDOCS/TESTIMONY/2005/20051103/default.htm>; Alan J. Auerbach, Jason Furman & William G. Gale, “Facing the Music: The Fiscal Outlook at the End of the Bush Administration, *Tax Notes* (June 2, 2008).”

¹⁶⁰ During World War I rates were increased to fund war expenditures. In the 1920’s rates were subsequently decreased. Anne Alstott & Ben Novick, *War, Taxes, and Income Redistribution in the Twenties: The 1924 Veteran’s Bonus and the Defeat of the Mellon Plan*, 59 *Tax L. Rev.* 373, 375 (2006) (tax rates increased from 7% in 1915 to 77% in 1918 and then decreased to 25% in 1926). Both Hoover and Roosevelt raised rates during the Depression. Roosevelt also raised rates in response to protests about concentrations of wealth and economic power. In the decades after World War II, the income tax changed dramatically but on an incremental basis. The top marginal tax rates since 1915 were: 2003-2010: 35%; 2002: 38.6%; 2001: 39.1%; 1993-2000: 39.6%; 1991: 31%; 1990-1988: 28%; 1982-1987: 50%; 1965-1986: 70%; 1964: 77%; 1946-1963: 91%; 1944-1945: 94%; 1942-1943: 88%; 1941:81%; 1936-1940: 79%; 1932-1935: 63%; 1925-1931: 25%; 1924: 48%; 1922-1923: 58%; 1918-1921: 77%; 1917: 67%; 1916: 15%; 1913-1915: 7%. Tax Found., *U.S. Federal Individual Income Tax Rates History, 1913-2010* (June 15, 2010), available at <http://www.taxfoundation.org/publications/show/151.html>.

1. *Interest Group Politics Predicts that Congress Will not Support Raising Taxes Directly*

The dominant and standard view of politics for the last several decades has been public choice theory, which is usually taken to mean interest group politics.¹⁶¹ That approach treats the government as an actor in what is essentially a market transaction, providing goods and services (via legislation) to interest groups that want to maximize the income of their members.¹⁶² Interest groups bid for legislation and pay for it with campaign contributions, votes in elections, and the like.¹⁶³

The originator of this approach, Mancur Olson, argued that two conditions could predict when effective interest groups would emerge and the policies that they would be interested in. The first is that the groups must be small. Although every member of a group stands to benefit from the results obtained, formation and coordination costs are high and they increase as the group grows in size. The second is the existence of free-riders. The desired legislation may affect a significantly larger group and this creates an incentive to free-ride, i.e. not to shoulder any of the burden of obtaining the legislation. Smaller groups lessen the coordination problem and narrower policy objectives lessen the free-rider problem. Thus, one would expect to see small groups who will gain a lot from very narrow objectives controlling legislation.

In the tax area, there is a fairly long history of examining interest group politics.¹⁶⁴ There have been several prominent attempts to explain tax legislation from a public choice perspective.

¹⁶¹ Little attention was paid to tax legislation during the heyday of public interest theory. Under this approach, the government is assumed to be motivated to improve general welfare by financing public goods and correcting for market failure. Those who hew to this explanation emphasize ideology—legislators have a desire to enact good policy that will improve society. No one seems to ever have suggested that tax legislation could be completely explained by public interest theory. This approach was subject to a good deal of criticism and ultimately was supplanted in the academic literature.

¹⁶² This approach is traced to Mancur Olson, *The Logic of Collective Action* (1965), and has been prominent ever since.

¹⁶³ See, e.g., Jonathan Macey, “Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model,” 86 *Colum. L. Rev.* 223 (1986). Public choice theory is not without its critics. See, e.g., Cass Sunstein, “Interest Groups in American Public Law,” 38 *Stan. L. Rev.* 29, 48-49 (1985); Mark Kelman, “Why Public Ideas Matter,” in *The Power of Public Ideas* 31 (R. Reich ed. 1988).

¹⁶⁴ See, e.g., William L. Cary, *Pressure Groups and the Revenue Code: A Requiem in Honor of the Departing Uniformity of the Tax Laws*, 68 *Harv. L. Rev.* 745, 747-73 (1955) (identifying sources of pressure on Congress to create special tax rules); Stanley S. Surrey, *The Congress and the Tax Lobbyist - How Special Tax Provisions Get Enacted*, 70 *Harv. L. Rev.* 1145, 1149-81 (1957) (attempting to enumerate reasons why tax lobbyists seek “loopholes”); Michael J. Graetz, *Reflections on the Tax Legislative Process: Prelude to Reform*, 58 *Va. L. Rev.* 1389 (1972); Thomas J. Reese, *The Politics of Taxation* (1980) (explaining the difficulty in passing meaningful tax reform legislation); Jeffrey H. Birnbaum & Alan S. Murray, *Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform* (1987); Timothy J. Conlan et al., *Taxing Choices: The Politics of Tax Reform* (1990) (analyzing the processes behind the passage of the Tax Reform Act of 1986); Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*.

Doernberg and McChesney argued that the increasing rate of federal tax legislation that proved to be unstable could be explained by Congress' responding to well-organized groups who paid for benefits that maximized their wealth.¹⁶⁵ They contend that business groups that lobby to obtain tax favors for themselves or their constituents are the primary "public" participants in the tax legislative process in which tax legislation is delivered to the highest bidder. These groups are interested only in short-term contracts rather than long-term deals because there is a turnover in the players on Capitol Hill. Politicians are also more interested in short-term deals because they can extract more benefit each time the process begins. Standard public choice theory posits that public interest or public opposition to interest groups will be diffuse and ineffective. In the tax arena, that opposition historically has come from the Treasury Department, the Joint Committee on Taxation and certain public interest tax lobbying organizations. These groups, however, have been largely ineffective.

Another version of public choice theory is that developed by McCaffery and Cohen, which they dub *ex ante* rent extraction.¹⁶⁶ McCaffery and Cohen concede that interest-group politics plays a major role in the development of legislation, but argue that it cannot explain all tax legislation. In brief, under this approach because Congress is addicted to the money received in the form of campaign contributions, it creates special interest groups from which it hopes to subsequently extract contributions. The difference between this mode of analysis and standard interest group analysis is that the politicians themselves solve the coordination problems. The politicians who are "rent-extracting" precede the interest groups that are "rent-seeking." They focus on tax provisions that apply to very few people who face high stakes. In a sense they threaten to eliminate the rent by imposing higher taxes or eliminating a tax incentive. This is most effective when the group affected has the ability to organize and be politically effective.¹⁶⁷

Interest group politics is a very robust explanation for the incremental legislation that comprises the overwhelming majority of tax legislation. Almost all provisions in tax legislation are incremental changes to the law as it exists and most clearly benefit specific interest groups, usually business.¹⁶⁸ There is no reason to believe that interest groups have lost any power over

¹⁶⁵ Richard Doernberg & Fred McChesney, On the Accelerating Rate and Decreasing Durability of Tax Reform, 71 *Minn. L. Rev.* 913, 926 (1987); Richard Doernberg & Fred McChesney, "Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986," 62 *NYU L. Rev.* 891 (1987).

¹⁶⁶ Edward J. McCaffery & Linda R. Cohen, "Shakedown at Gucci Gulch: The New Logic of Collective Action," 84 *N.C. L. Rev.* 1159 (2006).

¹⁶⁷ McCaffery and Cohen list five properties of rent-extraction: (1) the issue will be one of high stakes to a small group with a narrow policy focus that matters to the group (these are also the two conditions identified by Olson); (2) the issue will not be of much importance to most voters and therefore is not likely to be that important in election politics; (3) the issue should be two-sided, i.e. groups on both sides will be willing to pay so that legislators can gain no matter what their position is; (4) there must be plausible action that Congress can undertake; (5) the issue should be such that the legislation will be reasonably long-lived so that Congress cannot immediately undo it, thus negating an incentive for interest groups to pay. *Id.* at 1177-78. One result, according to McCaffery and Cohen, is that there is little incentive to actually solve the problem since stringing along all the interest groups creates more opportunities to pay. *Id.* at 1179. See also Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion* 45 (1997). For an example applying the rent extraction model, see Kysar, note 164.

¹⁶⁸ See generally Conlon et al, note 30, at 231-32. Interest group politics does not, however, explain all incremental tax legislation. There are some (although not many examples) that do not seem to be in response to

the last two decades nor is there any reason to believe that legislators are less interested in rent-extraction. In fact the reverse is true. There are number of factors that make it likely that interest groups politics will continue to control the political agenda and are likely to be a barrier to rate increases and raising revenue.

Both the rent-seeking and the rent extraction models predict that small groups with high stakes will emerge to control legislation, specifically legislation with concentrated specific benefits and costs to the groups. Conversely groups will have less interest in legislation with diffuse benefits and significant costs. One implication is that special interest groups largely will have no interest in general tax rate increases due to both coordination problems and free-riding. While there may be particular aspects of rate changes (for example, changes to the corporate tax rate) that might cause interest groups to form, general rate changes are not likely to spark the formation of such groups. Rate changes present the classic example of free-riding since almost everyone will be affected.

Setting rates is therefore a ballot box issue and neither rent-seeking interest groups nor rent-extracting politicians are interested in ballot box issues. The rent extraction model would predict that Congress would avoid a ballot-box issue, that is, one that is likely to have much appeal to voters generally, particularly in elections. On the surface, this seems incorrect. The evidence is that politicians devote a good deal of attention to taxes in election years. Presidential candidates especially often include comments about the tax system in their standard stump speeches and reform of the tax system is a perennial question in presidential debates but increasing taxes and facing the budget crisis is generally off the table.¹⁶⁹ Legislators also talk about taxes in election campaigns but interest group politics helps to explain why in fact they do not act on their expressed concern. Furthermore many congressional politicians are no longer concerned about re-election—they are assured of retaining their seats.¹⁷⁰ Thus, there is little need to move on a ballot box issue.

The ex ante rent-extraction model predicts that payments to politicians might occur simply to maintain the status quo.¹⁷¹ Increasing taxes upsets the status quo. While there might be winners, it is highly unlikely that they would be interest groups. There is very little way for Congress to

rent-extraction. For example, the legislation that created a uniform definition of child or two major simplification efforts, the Installment Sales Revision Act, Pub. L. No. 96-471, 94 Stat. 2247 (1980), and the Subchapter S Simplification Act were targeted quite broadly, Pub. L. No. 97-354, 96 Stat. 1669 (1982).

169 See Seema Mehta & Stuart Silverstein, Campaign '08: Democrats; Obama Courts Middle-Class Virginians with Tax Strategy, *L.A. Times*, Aug. 21, 2008, at A11 (Democratic candidate, Barack Obama proposing “ a \$1,000 tax break for most wage earners.”); Tom Redburn, Huckabee Sales Tax Plan Appeals, but is it Fair?, *N.Y. Times*, Jan. 6, 2008, at 1.16 (assessing Republican candidate, Mike Huckabee’s tax reform proposal to replace the federal income and payroll taxes with a national sales tax); Edward Wyatt & David Halbfinger, Clark and Kerry Offering Plans to Help Middle Class, *N.Y. Times*, Jan. 6, 2004, at A19 (Democratic candidate, Wesley Clarke pledges “to take back tax reform as our issue” by giving more tax breaks to the middle class.).

¹⁷⁰ Get statistics about incumbents in the last elections.

¹⁷¹ McCaffery & Cohen, note 166, at 1174.

extract money out of rate changes; thus it has very little interest in doing so. On the other hand, it is relatively simple for Congress to extract money in order to keep the status quo. Thus, legislators do have an interest in floating specific proposals that in keeping with the rent-extraction model might attract small groups facing large stakes. Public choice theory suggests that interest groups prefer repeat opportunities to bargain and legislators also prefer recurring opportunities to extract rent. Therefore those interest groups who are in fact lobbying for tangible benefits for their members are likely not to be interested in rate changes that might block future opportunities for bargaining.

2. Institutional Barriers Predict that Congress will not Support Increasing Taxes Directly

There are a number of institutional barriers that make it exceedingly difficult to reach a consensus on raising marginal tax rates or raising revenue. Our Madisonian system of checks and balances builds in a need for support from both the executive and legislative branches. Traditionally the political obstacles are overcome on rare occasions when a very strong president is elected with party majorities in both houses of Congress. The President then shapes public opinion to support legislative reform. This is usually what happens when there is anything that can be construed as tax reform.¹⁷² But shifts in party politics and the role of congressional leaders have changed this dynamic.

George Yin argues that over the last several decades there has been a strengthening of the party system and a corresponding decrease in committee leadership, especially in the House.¹⁷³ A number of events have created this situation. They include the repeal of the automatic seniority system for choosing the committee chairs as well as curtailment of the chair's power and reduction in committee staffs. At the same time the party assumed more control over legislation, including setting the agenda and providing language. While this was happening on the Hill, historically neutral tax policy advisors in the Treasury Department became less important as tax policy analysis shifted to the political office in the White House. Yin argues that the affect on tax legislation is ambiguous. A top-down organizational structure can offset the possibility that various committees acting independently can produce legislation that is not favored by anyone. Party leaders can require committees to commit to support legislation favored by the party. If the party has no interest in raising rates, the committees will not either. Also contributing to the lack of interest in real tax policy, Yin argues, is the loss of specialization benefits provided by strong committees and the decline in the committee's ability to provide good information. This factor is important, however, only if the parties are not interested in tax increases. For a long time the political party has been more important and neither party has shown much interest in the budget crisis or in additional sources of revenue.

¹⁷² See Susan B. Hansen, *The Politics of Taxation: Revenue without Representation* 62 (1983) ("major tax innovations show strong links to periods of political realignment and social crisis, in marked contrast to the incremental policies characteristic of 'normal' politics").

¹⁷³ George K. Yin, "Is the Tax System Beyond Reform," *Dunwoody Distinguished Lecture in Law*, University of Florida School of Law, in 58 Fla. L. Rev. 977 (2006).

Another aspect of this is the Permanent Campaign.¹⁷⁴ The necessity for Congress to be constantly involved in a re-election campaign that requires huge amounts of fundraising has resulted in an external focus that does not permit time for working as a collaborative body for the public good.¹⁷⁵ The economics of campaign financing are such that House members especially must spend virtually all their time raising money, usually far away from Washington.¹⁷⁶ Because members are often in very safe seats,¹⁷⁷ they are not worried about ballot box issues, particularly issues that might actually cost votes. Instead they are most interested in raising money. The huge amount of time that must be focused on fundraising and campaigning during the permanent campaign makes it difficult to mount a huge and potentially unpopular undertaking such as solving the budget crisis. There is time only for symbolic efforts.¹⁷⁸

Another institutional factor is budget rules, specifically PAYGO rules. Budget policy is no longer exogenous to tax policy and there are features of budget policy that make all significant changes to the tax system quite difficult. When Congress operates under pay-as-you-go budget rules (PAYGO), any legislation to lower revenues or expand entitlement spending -- relative to current law projections (i.e., the "baseline") -- must be offset with corresponding revenue increases or spending cuts. However, unlike the statutory PAYGO rules that expired several years ago, which required sequestration by the Executive branch if they were violated,¹⁷⁹ the current rules are internal rules that Congress must choose to enforce and can waive by a supermajority vote.¹⁸⁰ The fact that Congress recently approved an AMT patch without providing for revenue offsets¹⁸¹ is evidence that PAYGO rules may not be a strong barrier. Even in the absence of the PAYGO rules, Congress has often acted with a revenue neutrality constraint. Both Treasury I and the recent tax reform panel also operated under a revenue neutrality constraint, that is reform must raise no more and no less than current revenue raised by

¹⁷⁴ The term comes from *The Permanent Campaign and its Future* (Norman J. Ornstein & Thomas E. Mann, eds. 2000). The book's thesis is essentially that there is no longer any distinction between governance and campaigning.

¹⁷⁵ See Yin, note 173, at 1025.

¹⁷⁶ See Daniel Shaviro, "Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s," 130 U. Penn. L. Rev. 1, 10102 (1990) (discussing the effects of campaign financing).

¹⁷⁷ Get statistics

¹⁷⁸ See Yin, note 173, at 1029. Yin gives as an example of the lack of seriousness with which Congress addresses significant policy issues, the perennial introduction of the Tax Code Termination bill which would repeal the entire code to be followed by an unspecified simple and fair tax. *Id.* & n.203.

¹⁷⁹ Budget Enforcement Act, Pub. L. No. 101-508, tit. XIII, § 13101, 104 Stat. 1388-573, 1388-575-1388-577 (1990).

¹⁸⁰ Statutory Pay-As-You-Go Act of 2010, Pub. L. No. 111-139, tit. I, 124 Stat. 8.

¹⁸¹ American Recovery and Reinvestment Tax Act of 2009, Pub. L. No. 11-5, tit. I, §§ 1011-1012, 123 Stat. 115, 319.

the income tax.¹⁸² While it would appear that the need for revenue neutrality would make it easier for Congress to raise tax rates directly to offset spending proposals, in practice it has had to resort to indirect means.

3. Mitigating Factors that Might Result in Raising Taxes Directly Are not Likely to Occur

There are different forms of politics that might create a setting in which tax increases might be considered but those forms are either not present or lead to the opposite conclusion. Conlon, Wrightson and Beam argue that one important factor is the “politics of ideas.”¹⁸³ Four factors might push interest group politics to the side. The first is the concept that ideas are an independent and influential force in politics. The key difference between the politics of ideas and interest group politics is that individuals will not necessarily act in their own self-interest—at least in their own economic self-interest. They will be motivated by ideas or values that if carried into force would not necessarily provide a personal economic gain.¹⁸⁴ Their second factor is that the power of ideas was expressed in symbolism or in public relations values. Third experts will play a major role. As David Bradford has noted, “experts inevitably shape the crucial details of economic regulatory systems.”¹⁸⁵ The fourth factor is the role played by policy entrepreneurs (“someone who assembles the key ingredients essential for government action”).¹⁸⁶ Shaviro also attributes the rise of policy entrepreneurship as one factor that offsets a narrow reading of interest group politics as the only explanatory fact. By policy entrepreneurship he means “the investment of personal resources in promoting a particular policy, with the anticipated ‘return’ often depending on the enactment of legislation.”¹⁸⁷

While to some extent there has been a politics of ideas with respect to taxes for the last decade, that idea has largely been the demonization of taxes and the need to keep rates low. No politics of ideas has coalesced around the need for steps to solve the budget crisis. Symbolism and public relations with regard to taxes has occurred but it has pushed in the other direction. To date there has been no real attempt to educate the public about budget unsustainability nor has it caught the public imagination. Experts on the other hand have spoken forcibly but have been

¹⁸² See President’s Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America’s Tax System 42 (2005), available at <http://www.taxpolicycenter.org/taxtopics/upload/tax-panel-2.pdf>; U.S. Treasury Dep’t, Tax Reform for Fairness, Simplicity, and Economic Growth 14 (1984).

¹⁸³ Conlon et al., note 30; see also Shaviro, note 176, at 98 (nothing that ideas matter a great deal; politicians pursue ideological ends and ideas sway people in masse).

¹⁸⁴ Conlon et al, note 30.

¹⁸⁵ David F. Bradford, Tax Reform: Waiting for a New Consensus of the Experts,” 79 Tax Notes 899, 899 (May 18, 1998).

¹⁸⁶ Conlon et al, note 30, at 247 “[Entrepreneurs] act as middlemen between professional experts, who formulate and perfect policy solutions, and the broader political arena. Entrepreneurs simplify and distill those complex ideas and then link them to values that are accepted by and are familiar to the broader public.” Id. at 247.

¹⁸⁷ Shaviro, note, 176, at 93-94.

unable to seize the spotlight and so far there has been no policy entrepreneurship with respect to the budget. To some extent this must be attributed to the weakness of congressional leaders. Shaviro notes that congressional leaders have stronger prestige and ideological incentives than rank and file members and tend to be less subject to interest group influence.¹⁸⁸ When congressional leaders control the legislative process, interest groups are less likely to influence legislation. This creates the opportunity for policy entrepreneurs among the leadership. If that leadership was interested in raising revenue, they would have an opportunity to move it to the legislative agenda. But congressional leadership today is not nearly as strong as it previously was. One take-away from this evolution is that interest group politics becomes more important. Another take-away is that this congressional leadership has been displaced by party control.¹⁸⁹ The rise in the power of the party has also been accompanied by inter-party polarization. The last decade has witnessed virtually no bipartisan efforts in Congress. And yet almost everyone agrees that a bipartisan effort would be necessary to tackle the budget crisis.

What about the possibility of external pressure for the public interest? Historically the leadership for unorganized interests or for the public interest came from the Treasury Department and the Joint Committee staff. These two bodies were assumed to be operating in the public interest—they had institutional interest in tax policy that operated as a counterweight to economic self-interest. Over the past decade, however, their influence has waned, particularly during periods when the offices were thought to be politicized.¹⁹⁰ While both offices still provide neutral evaluations of policy, their voices no longer can be considered a strong offset to interest group politics. Much the same can be said about public interest not-for-profit organizations interested in tax policy. While several of them provide good data and reports,¹⁹¹ they do not seem to have much effect in the political arena. Another notable decline in influence is that of labor unions who historically have represented diffuse groups—such as lower and middle income taxpayers. Today labor unions have almost no voice in the tax policy debate.¹⁹²

Finally, interest group politics can be offset by diffuse unorganized interests provided there is a strong consensus. Public opinion can act as a constraint on the legislative process.¹⁹³ In this case, as explained further below, public opinion seems to be strongly in favor of no rate increases rather than the opposite.

4. The Poisonous Atmosphere with Respect to Taxes Prevents Increasing Taxes Directly

¹⁸⁸ Id. at 102.

¹⁸⁹ See the discussion *supra* of institutional factors.

¹⁹⁰ add cites for decline in influence

¹⁹¹ Tax Policy Center, Tax Analysts

¹⁹² Cite Graetz estate tax book

¹⁹³ See, e.g., William N. Eskridge, Jr., Politics without Romance: Implications of Public Choice Theory for Statutory Interpretation, 74 Va. L. Rev. 275, 287 (“unorganized interest may still have an impact if their preferences are strong and commonly held, for public opinion itself works as an important constraint on legislative action.”).

Perhaps no other factor better explains current tax politics (and thus the unlikelihood of raising additional revenue) than the poisonous rhetoric with respect to taxes. It is widely agreed that public discourse about taxation has taken a nosedive and it is impossible to discuss taxes in any serious way.¹⁹⁴ The anti-tax movement can be traced to Ronald Reagan, whose fight for smaller government inevitably brought with it a call for lower taxes. There are many who have carried this forward from those who want to scrap the Code,¹⁹⁵ to the Contract with America's anti-tax rhetoric,¹⁹⁶ to Steve Forbes' one-note presidential campaign,¹⁹⁷ to the campaign against the so-called "death tax,"¹⁹⁸ to the most recent campaign and the jockeying to make the most serious pledge not to raise taxes.¹⁹⁹

This is largely attributable to two factors: the obsession with marginal tax rates and the impossibility of adopting any legislation that could be framed as "raising taxes." Congress and politicians go to extraordinary lengths to steer clear of taking any action that might be construed as raising taxes. This involves both labeling revenue-raising measures as something other than a tax as well as trying to avoid raising the tax burden on any one. An example of the first is the struggle to describe the penalty associated with the insurance mandate in the health care legislation. An example of the second tactic is the struggle over the 2001 and 2003 Bush tax cuts. Politicians are only too familiar with what happens if they can be tagged with raising taxes. The most salient example is President George's Bush's "read my lips" pledge—it was widely assumed to be a major contributing factor in his unsuccessful re-election bid when his actions did not follow his lips.²⁰⁰

For the last decade one political focus has been on *marginal* rather than effective tax rates.²⁰¹ Both the president and Congress are terrified of the political repercussions of increasing the top marginal tax rate. One fallout from this obsession is that there can be no public discussion of

¹⁹⁴ Daniel Shaviro, "The Long-Term U.S. Fiscal Gap: Is the Main Problem Generational Equity?," 76 *Geo. Wash. L. Rev.* 3 (2009) ("debasement of public discourse, and near impossibility of reasoned mainstream political debate about fiscal sustainability").

¹⁹⁵ Alison Mitchell, Leaders of G.O.P. Seek to Overhaul Federal Tax Code, *N.Y. Times*, Sept. 28, 1997, at 1.1.

¹⁹⁶ See Republican Contract with America, available at <http://www.house.gov/house/Contract/CONTRACT.html> (last visited Aug. 17, 2010).

¹⁹⁷ Leslie Wayne, Forbes Emphasizes Position Against Abortion and Taxes, *N.Y. Times*, Jan. 23, 2000, at 1.16; Leslie Wayne, Flat Tax Goes From 'Snake Oil' to G.O.P. Tonic, *N.Y. Times*, Nov. 14, 1999, at 1.1.

¹⁹⁸ Michael J. Graetz & Ian Shapiro, *Death by a Thousand Cuts: The Fight over Taxing Inherited Wealth* (2005).

¹⁹⁹ Add cites

²⁰⁰ Paul Taylor, "Bush's Vivid Self-Portrait: Caring, Practical Everyman Depicted," *Wash. Post*, Aug. 19, 1988, at A1; Charles Krauthammer, Trapped by Campaign Rhetoric, *Wash. Post*, Feb. 26, 1993, at A23.

²⁰¹ A focus on rates also brings a focus on redistribution with winners and losers. As Michael Graetz has pointed out, the discussion has been changed to the distributional tables. See Michael Graetz, Paint-by-Numbers Tax Lawmaking, 95 *Colum. L. Rev.* 609 (1995).

raising revenue through a change in the rate brackets. Obviously, there are other ways to raise revenue—for example, by expanding the base—but the second factor precludes that as well. Anti-tax forces, particularly the Republican party, have relentlessly driven home the point that anything that might be described as a tax increase is bad. Thus, for example, failing to extend a temporary provision is a tax increase.²⁰²

This poisonous atmosphere is exacerbated by the public's lack of understanding about taxes. The public is remarkably uninformed about fiscal policy and taxation's role and this ignorance prevents a public consensus that will act as a constraint on legislation as usual. While there are of course excellent and reliable sources of information about tax policy, their readership is essentially limited to the cognoscenti. The public, on the other hand, gets most of its information about tax policy from the general media, which usually limits its discussion of taxes to sound bites. Most of this information comes in the form of hostility to the concept of taxation. Politicians fan this hostility to taxes, both the rates and the idea that our income tax system is truly awful.²⁰³ Although the severity of the rhetoric appears to be aimed at goading taxpayers into supporting change, the effect may be just the opposite.

Another problem is that all of the public discussion focuses on the revenue side and very little on the spending side. Most taxpayers do not seem to object to pronouncements about the need to end big government but it is clear that they do not want to terminate any spending program of which they are a beneficiary. What motivates taxpayers has been remarkably constant over the last several decades: to pay as little tax as possible but to receive as large public benefits as possible.²⁰⁴ This is entirely consistent with public choice theory since taxpayers are looking for their own self-interest.

5. The Use of Low Salience Taxes as a Second-Best Solution

While no doubt economic considerations such as efficiency are important, in the real world, tax policy is often dictated by politics. That affects the normative argument with respect to the government's taking advantage of cognitive error. While it would be counterproductive in many cases for the government to rely on low-salience tax provisions, there are situations whether they may enable the government to achieve otherwise worthy goals. So long as the process is reasonably transparent and information with respect to the provision is readily available, there is no convincing argument that it would be wrong for the government to take error into account by effectively using politically-pleasing taxes or provisions. The salience of the tax is exogenous to the provision itself in that it arises from the inability or unwillingness of a taxpayer to fully understand or react to a given provision. Thus, an attempt to minimize the perceived burden of a tax is not wrong per se. One reason that is so is because all the information necessary to determine the actual burden is available.

²⁰² Although in theory this shifts the discussion to decreasing spending, in actuality there is little discussion of either and certainly no discussion of trade-offs.

²⁰³ See Marvin A. Chirelstein, *Taxes and Public Understanding*, 29 Conn. L. Rev. 9 (1996) (noting public hostility to federal income tax, both paying taxes and the system itself).

²⁰⁴ See Shaviro, note 176, at 57.

In other situations, the government may intentionally adopt tax provisions that are expected to change behavior, Pigouvian taxes. For example, incentive provisions are designed to encourage specific behavior (and disincentive provisions are designed to discourage certain behavior). In that case, salience is required. We would expect that a low-salience provision would not accomplish the intended goal and thus using a low-salience tax would be inappropriate.