5 Myths about your taxes

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April is here, which means it's almost time to pony up and render unto Caesar. We've gathered our receipts and other documents, and dragged ourselves to the strip-mall tax preparer or fired up do-it-yourself software to determine how big our refund is -- or how much we owe Uncle Sam. No one likes to pay taxes, but as we get ready to stand in line at the post office on the 15th, it might be useful to dispel some of the most common myths about this springtime ritual.

1. The poorest and the richest Americans pay no taxes.
About 45 percent of households will owe no federal income tax in 2010, according to our estimates. Half of them earn too little, while the other half -- mostly middle- and lower-income households -- will take advantage of tax credits such as the earned income credit, the child and child-care credits, the American Opportunity and Lifetime Learning credits, which help pay for college, and the saver's credit, which subsidizes retirement saving.

But even citizens who pay no income tax still pay other kinds of taxes. They pay Social Security and Medicare taxes when they work, sales taxes when they buy things and property taxes on their homes. Drivers pay gasoline taxes, and smokers and drinkers pay excise taxes on tobacco and alcohol. According to our research, more than 75 percent of us will pay at least some form of federal tax in 2010.

Those who pay no federal taxes are mostly the low-income elderly or very poor families with children. Even about half of those with annual incomes under $10,000 pay some federal tax, most often payroll taxes on wages.

And yes, the richest Americans pay taxes, too. Though a tiny minority manage to avoid federal income tax through elaborate tax planning, 99.7 percent of those with annual incomes above $1 million will pay federal taxes this year, surrendering 27 percent of their earnings to the government. The average American taxpayer pays 18 percent.

2. Americans are overtaxed.
In 2007, federal, state and local taxes claimed about $3.8 trillion, or 27 percent of U.S. gross domestic product. That's nearly $13,000 for every American. Two-thirds of tax revenues went to the federal government.

It may sound like a lot, but other developed countries collect even more. In 2006, taxes in 30 of the world's richest countries averaged 36 percent of GDP; only Mexico, Turkey, South Korea and Japan had tax rates lower than ours. And taxes in many European countries exceeded 40 percent of GDP because these nations offer more extensive government services than the United States does.

Americans do pay far more in individual income taxes than residents of other wealthy nations. Nearly 37 percent of U.S. tax revenue came from personal income taxes in 2006, about 10 percentage points more, on average, than in other industrialized countries. But we pay much less in sales taxes; 17 percent of 2006 U.S. tax receipts were from taxes on goods and services, or about half the 32 percent average for rich countries.

Bottom line: We may hate our taxes, but we pay far less than people in other wealthy countries.

3. Higher taxes could eliminate the federal deficit.
Washington spends more than it takes in through tax revenues, resulting in a projected budget deficit of almost $1.35 trillion in 2010, or 9 percent of GDP, according to the Congressional Budget Office. Couldn't we get rid of the deficit by raising taxes?

No. A study we conducted at the Tax Policy Center found that Washington would have to raise taxes by almost 40 percent to reduce -- not eliminate, just reduce -- the deficit to 3 percent of our GDP, the 2015 goal the Obama administration set in its 2011 budget. That tax boost would mean the lowest income tax rate would jump from 10 to nearly 14 percent, and the top rate from 35 to 48 percent.

What if we raised taxes only on families with couples making more than $250,000 a year and on individuals making more than $200,000? The top two income tax rates would have to more than double, with the top rate hitting almost 77 percent, to get the deficit down to 3 percent of GDP. Such dramatic tax increases are politically untenable and still wouldn't come close to eliminating the deficit.

4. Most people's tax returns are way too complicated.
No one claims that our tax system is simple. After all, the Internal Revenue Code runs more than 3 million words, and the instructions for the widely used 1040 form take up more than 100 pages. Small wonder that three out of five tax filers pay someone to prepare their returns, and another one in five uses software.

But most Americans have relatively simple tax returns. Nearly two-thirds of us claim the standard deduction and don't have to itemize our deductible expenses. And 40 percent of us file one of the simpler tax forms: the 1040A or the 1040EZ. The 2009 EZ has just 13 lines. Relatively few of us get income from any source besides wages and salaries, interest, dividends, and pensions, so it's not hard to tally how much we took in.

So why do taxes seem so complicated? Blame Congress. Legislators use the tax code not just to collect revenue but also to encourage and reward specific activities. The 1986 Tax Reform Act greatly simplified the income tax by getting rid of many special provisions and cutting the number of tax brackets. Since then, Congress has expanded the earned income and child-care credits, created the child, saver's, and education credits, established health savings and Roth retirement accounts, imposed different tax rates on dividends, created a class of long-term capital gains with a lower tax rate and doubled the number of tax brackets.

Last year's stimulus bill added temporary tax cuts that benefit house and car buyers, workers, and families with children, but also make tax returns longer and harder to complete.

5. You should aim for a big tax refund.
It's wonderful to receive a big check in the mail. And having to write a check to the IRS is never fun. But you're better off owing the government a small amount on April 15 than receiving a huge refund. Here's why: Even though it seems like you pay your income taxes once a year, you actually pay them all year long as your employer withholds taxes from your paycheck. When you file your tax return, you are refunded the difference between the tax you owe and the cash your employer withheld.

Three-quarters of Americans allow their employers to withhold too much; income tax refunds averaged nearly $2,300 in 2008. In effect, we're giving the government an interest-free loan. You'd be better off stashing these withheld wages in an interest-bearing bank account and writing a check to the IRS on April 15.

It's not hard to cut the amount of money withheld from your paycheck. Just give your employer a W-4 form asking to withhold less each payday. Your human resources office should have the form, and it's easy to fill out. But there is a catch: If you owe too much (and there are specific rules defining what "too much" is), you may have to pay a penalty -- usually interest on the unpaid tax. And if you're not careful, you may end up owing more in taxes than you saved.

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