TAX RATE WARFARE and *DOUBLE TAXATION* – LET ME SAY THIS ABOUT THAT!

Stephen L. Bakke – February 2, 2012

Now I hear folks running around calling this class warfare. This is not class warfare, let me tell you something. Asking a billionaire to pay at least as much as a secretary, that's just common sense. – President Barack Obama

---

Democrats and republicans alike have "gotten all caught up in their under-shorts" over the topic of tax rates for Warren Buffet, Mitt Romney et.al, compared with tax rates for "lowly secretaries." And then someone introduced the topic of the unfairness of "double taxation." Woe is me! What is this all about? Do any politicians or commentators ever explain the issue, or are they just "reading from a script"? I think the latter applies! I think this all blends well with my prior reports on "class warfare," "who pays taxes," "equality," "fairness," "class mobility," etc.

As usual, I'm totally frustrated by the lack of information our politicians and the media give us to work with. While I believe our President to be guilty of underestimating the intelligence of "we the people," republicans often do the same thing. But are they patronizing us, or perhaps they don't know the facts either? Hmmmmmmmm?! That's why I remain a "conservative independent."

Let's Take this Apart, Piece by Piece

Please be assured that I am fully supportive of comprehensive tax reform which would simplify the system and would remove virtually all methods of "reducing" taxable income through deductions and "favored son" treatment. There would be no social agenda in the tax system and there would be no politically/bureaucratically determined "winners and losers." All Americans above the "poverty level" would pay something. This could be a modified/graduated "flat tax," for example. Consider:

- First of all, the current maximum marginal federal tax rate for individuals is 35%. I have heard it bantered about that Warren Buffett's secretary pays up to twice the rate that Buffett pays, which is approximately 15% to 20%.
- Secondly, no-one now pays an overall tax rate of 35% because that rate only applies to income earned **over** a certain level. That level has been (drumroll please ………….) between $350,000 and $400,000 in recent years. So if Buffett's secretary is paying between 30% and 35% in federal taxes, she just happens to be a very wealthy individual separate from her employment by Warren. She would be well into that "hated 1%"! More on this later.
- Next, the maximum marginal corporate federal tax rate is 35% - or so they say. Even our President admits the U.S. corporate rates are high compared to other countries – bad for competition and international trade.
- Capital gains and dividends are taxed at 15%. They are properly considered taxes on capital, and contrary to some misguided opinions, lot's of people other than the "hated 1%" benefit from this policy.
- "Double taxation" means that the **same income** is taxed again and again …… and again.

Now Let's Tie it Together

How does all this relate in terms of "some rich guy" who only pays 15% on dividends and capital gains? I'll tell ya' how! That rich guy owns the company that pays up to 35% in marginal tax rates. For simplicity, let's assume this company isn't one of the "winners" selected by our ridiculous political system and tax code, and which therefore might pay little or no federal taxes. Those limited occurrences are the exception, and should be eliminated.

Tax payment number one! The **"rich fat cat" guy (RFC)** owns the company, and therefore the company's income is his as well (Well, I would hope so!). And taxes should be paid, at least indirectly, by the RFC (Well I would hope so!). "No problemo" so far. The corporation is a "C Corp" (as opposed to a "Sub S" corporation, or LLC – these are deemed to pass all income through to the owners for tax purposes) and therefore files and pays income taxes. Therefore, when the RFC's company files taxes, the RFC has in fact paid the tax because his (some say "ill-gotten") net worth (undistributed corporate equity) is reduced by as much as 35% of the company's income.

Tax payment number two! The RFC is paid a dividend. A dividend can be **accurately described as** a distribution of corporate income previously subject to taxes. The greedy RFC pays another 15% on the same income on which the company paid taxes. But remember that some income was retained by the company.

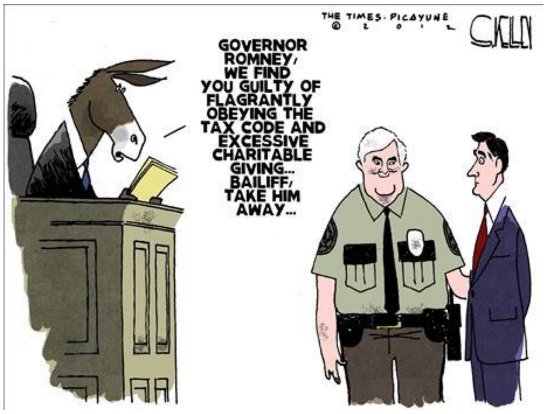
Tax payment number three! (Please forgive me for over-simplifying here!) RFC decides he wants to "cash in" on his "ill-gotten" gain (assuming RFC is fortunate enough to have a gain) by selling his stock in the company, which qualifies for "long term capital gains treatment." That gain is taxed at 15%. How is this "multiple taxation" you say? The (hopefully high) price RFC gets for his stock ideally will provide him a profit over the amount of capital he has invested in the company. Part of the "gain" is simply caused by "retained (previously taxed) earnings" of the company. Another part of RFC's gain is more intangible and is created by the "marketplace valuation." To the extent the "realized" value reflects retained earnings, those previously taxed earnings are taxed once again.

And the estate tax – is that tax payment number four? That's a discussion for another day!

Here's what all the "kurfuffle" is about! If we look at all this as a package, and if you grant me the convenience of not solving at least three "simultaneous linear equations" to prove my point, the result is that the RFC, combined with his "alter-ego company" have paid an effective federal tax rate on the original taxable earnings of almost 50%. Isn't that enough?! Or, stated another way, if you own a corporation that pays taxes, and if you received dividends and ultimately sell that corporation, you may get to keep as little as 55%. And don't forget, estate taxes will effectively take a lot more from your previously taxed earnings and assets.

Disingenuousity (????) – Whatever That Means – It's Goin' On!

Part of the problem is that we always get ½ (or less) of the facts. Just keep all of the facts in mind as you judge what's going on in this debate. Did the stories about Romney giving 19% of his income to charity ever make the front page? Is that not relevant in judging the man? Was it ever reported that Romney's returns were prepared with the utmost precision and in full compliance with the tax code? No! Yes! and No!



Since the democrats (and some republicans) are taking after Romney about his "low" tax payments, but ignore his immense charitable giving, consider just a couple facts. While Romney pays almost 20% of income to charities, Obama paid between 1 and 5 % to charities over the last few years. Biden? He paid a total of $369 in 2009, and approximately $5,000 in 2010. And at the risk of being accused of "muck-raking," dozens of Obama's executive office staff owe back taxes – totaling almost $1 million.

Disingenuousity? Hey! This Has Become Outright Disingenuousness! Could I Be More Clear!

Warren Buffet has been self-righteously bemoaning that he doesn't have to pay more taxes, and that his poor secretary pays much more than he does. Recall earlier in this report that I speculated about his poor secretary actually being a very wealthy woman. That's a logical conclusion if she is indeed paying much more taxes than Buffet. I have been looking for information about this and have found enough from credible sources and news services that I will go with it as "directionally and substantially" correct, if not nailed down exactly. While "poor secretary" is paid approximately $60,000 annually by Buffet, information I have seen indicates that her actual income is between $200,000 and $500,000 annually – and she owns two homes! She's in the 1%, after all!

Considering those numbers for the "poor secretary," is it any wonder that she does pay something in excess of Buffets taxes? He purposefully pays himself only $100,000 salary, and all other payments made to him are investment dividends and capital gains which are taxed at 15%. He **chooses** to do it this way, ladies and gents! He could direct more to salary, but he doesn't!

Consider that while Buffett is bemoaning the huge break being given to the wealthy, and while he expresses a desire for an increase in taxes on capital, those policies he is fighting against actually help him in his business ventures. For example, while he has repeatedly supported higher estate tax rates, he is well known for "buying up" family businesses unable to pay estate taxes without liquidation. And he is heavily invested in insurance companies that sell products to help other citizens avoid the "death tax" as part of their estate tax planning.

The cuddly old rich guy isn't so cuddly after all! This reminds me of the old rhyme which concludes: "Fuzzy Wuzzy wasn't fuzzy, wuzz-he?

Obama Hopped on Board and Started Referring to a new Tax Proposal as the "Buffet Rule"

What if Obama's "Buffet Rule" had been in effect in 2011, whereby all RFCs (with incomes over $1 million) would pay a minimum tax of some high percentage (say 30% - the details aren't yet officially available)? Would that have helped? Let's see, according to my computation, the deficit in fiscal year 2011 would have been $1,240,000,000,000 rather than $1,280,000,000,000. Let's "shoot the moon" on that one and go for it! Don't you think we should? GOOD GRIEF!

I want to report here that if you are one who wants the tax on capital to increase, you will be pleased to hear that after this year the capital gains rate will go up to almost 20% and then Obama has suggested another increase to 24% - and that on top of having the current corporate income tax rate far higher than any other industrialized country. Do ya' "spose" that corporate executives take tax rates into account when certain operations are moved to other countries? GOOD GRIEF!

But I Digress! So Consider This Alternative for a Moment

How about if all owners of corporations, including all the "rich fat cats," merely paid taxes on their share of corporate taxable earnings? And what if they paid taxes at the maximum individual rate of 35%? No more capital gains or dividend taxes! And no more corporate income taxes! Let the RFCs pay the freight! Would that satisfy Obama and many of his backers? I've seen evidence that it would. Would that raise more taxes and do it more fairly? Nope! Neither! Think about it a while!

I just don't get it! For me, this is the most counter-intuitive administration I have ever observed!

> ***Why is it "fair" or "equal" to create a lower tide that pulls down all boats?*** – Larry Kudlow (former Obama supporter)