

CLASS WARFARE CAN GET “TAXING”!

Stephen L. Bakke – December 12, 2010

How’d We Get Here?

It happened something like this:

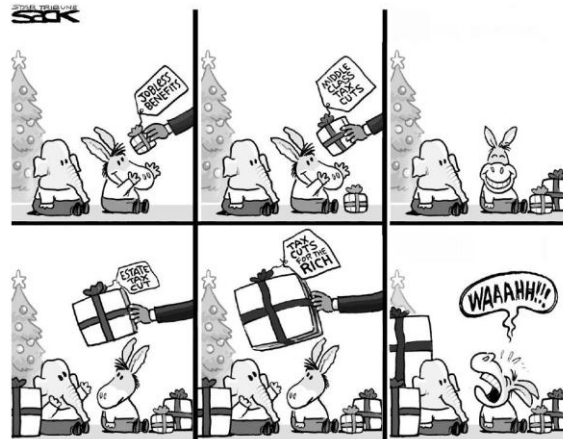
- George W. Bush successfully achieved a tax rate reduction bill almost 10 years ago. All taxpayers benefited – with lower incomes experiencing proportionately more relief than the rich (contrary to popular liberal opinion). Tax issues are always controversial so the legislation ended up with a “sunset provision” which will occur on January 1, 2011. Without further legislation, all tax rates will revert to the levels of 10 years ago.
- Bush’s program worked! And tax revenues increased substantially in spite of the rate reduction. Several years of fiscal growth, and economic prosperity followed, to be interrupted mainly by the housing bubble and mortgage crisis. And that affected everybody – rich, poor; business, labor; employers and employees. The cause? There’s plenty of blame to go around but the Community Reinvestment Act (CRA) started it all.
- The well intentioned CRA legislation ended up putting real estate in the hands of more lower income families – not bad in itself. But eventually, the artificial demand dramatically drove up the price of houses, and many owners ended up with mortgages they couldn’t afford. All in the name of “fairness.” **Bad things happen when the government tries to override the free market system.** Fannie and Freddie, with a push from some legislators, greased the home-buying skids. Result? The bubble!
- Comparing economic or employment statistics from early 2009 with early 2001 is a “red herring.” The collapse came as described in the last point, not from the tax policy.
- Early in 2010, speculation began about addressing the issue of these soon to be expiring tax rates. It was brought by the democrats for limited debate (reluctantly I believe), but it appears that no vote was held prior to the November election because the democrats saw negative fallout as one possible result of a vote. But the republicans did well in the election – gaining control of the house and more power in the Senate.

Mallard Fillmore by Bruce Tinsley



- Then came Thanksgiving, and now here we are, a little over two weeks away from January 1. And the rhetoric is flying. It’s great fun watching cable, particularly the “C-SPANs” – at least for a political junky like me.
- Recognizing the predicament, President Obama independently negotiated with the republicans as to the framework for bi-partisan tax legislation. Extending the current rates, including for “rich people”, for two years. It also extends unemployment compensation, and provides a reasonable (I think) compromise on estate taxes.

- In January, the republicans will take control of the House. And in the Senate, the republicans will be strong enough to block bad legislation. If the tax rate legislation is left for January, the republicans will have more leverage for negotiation than at present.
- So, here we are, with the debate and vote about to occur, and extremes of both parties are very unhappy with the proposed legislation.
- I predict Obama will get his way, with reluctant support from members of both parties.



But the Democrats Could Overplay Their Hand (As Many Republicans Hope!)

Now is the time for the democrats to count their blessings that the republicans seem to be willing to compromise. But there is a real possibility that no passage will happen before the new year, and if so, the republicans probably will eliminate or reduce the unemployment extension, be more aggressive in imposing their views on estate taxes – and most importantly, they will probably attempt to make all the tax rates permanent. But the President will probably veto any such attempt, and more negotiations will be necessary. **Ain't this fun?!**



Class Warfare – The Democrats' Ideology

Democrats/liberals/progressives are ideologically opposed to permitting the tax rate extension to apply to wealthy Americans. Progressives loyally seek the utopian ideal of total equality. They

are blind to some of the realities of our culture and economy. They don't realize the foolishness of their strategy of delaying the debate and vote. They don't understand the futility of "making like Custer" in their "last stand" before losing the majority in the House, and significant power in the Senate. But holler they do!

I repeat something I have written before: Liberals/progressives are so passionately opposed to their opponents they actually create a frightening image of the republicans/conservatives as being bad and evil – hence justifying their "last stand" mentality – "damn the torpedoes and full speed ahead." They truly seem to value total equality as preferable to less equality, more opportunity, and greater average prosperity for all. Go figur'??



I've Said It Before, and I'll Say It Again!

Whether we like it or not, increasing the tax rates for the highest incomes is a poor way to increase revenue. Yes! the richest can afford to pay more. But they aren't stupid! They move their money from taxable investments to tax shelters and non-taxable investments. So what? Those funds are put into conservative capital preservation assets that don't create growth and jobs. And historical statistics, along with human nature, clearly indicate that the result of tax increases, particularly at the upper income levels, is usually a reduction in total tax revenue. **Lower tax rates for the wealthy creates an atmosphere of aggressive investment in growth opportunities which does create jobs and profits and more tax revenue than is given up in the rate reduction. You may not like it, but that's a demonstrable fact!**

Let me demonstrate based on personal experience. A number of years ago I was a founder of a new company. In order to achieve our operating and growth plans, we needed to attract significant capital from outsiders. While this was a small company, we still needed several million dollars in pure capital from investors in order to attract the necessary bank loans and achieve our growth and profitability goals. Who were these investors? Wealthy individuals who invest their wealth in growth opportunities. We planned to make profits. And we knew eventually the company would be sold – for a profit. All of these profits brought with them income tax implications. **If the tax rates had been sky high, or if it were not certain how much future rates would go up, I would not have raised that money.**

Wealthy individuals and corporations are accused of standing on the sidelines and hoarding money. I assure you, if they were less uncertain about the democrats' attitude toward profits and tax rates, their money wouldn't be sidelined. Democrats claim, if rates are lowered the rich won't spend the funds, whereas those in lower tax brackets will spend these new dollars and help the economy. **Wrong! The wealthy won't spend funds on consumer goods, that's true. But they don't just put their money in a trunk and bury it.** When they see lower taxes on profits, they move their money from tax sheltered, non-growth investments to investments like I described in the prior paragraphs – thus creating jobs and growth. You don't have to spend your money on potatoes, shoes, or TVs to be able to claim you money is helping the economy! It appears that democrats can't connect the dots between wealth, investment, developing businesses and technologies, and jobs. **Remember – like it or not, it takes wealth to encourage more wealth!**

An Example of the “Rich” – Millionaires and Billionaires

The “rich,” as defined by Obama and the democrats, starts at an “arbitrary” family income level of \$250,000. That's a comfortable income level to be sure. But reality isn't always what meets the eye (or ear, or brain). Consider the example of a small business owner who has a family. The owner pays him/herself \$100,000 per year which is well under the democrats' “enemy territory.” But the story doesn't stop there. The business is probably set up as a partnership, limited liability company, Sub-S corporation, or sole proprietorship. Further assume that after payroll and all expenses, this company earns a profit of \$175,000. The owner leaves this in the company for growth capital. Guess what! That business owner has to include that \$175,000 as income on the family tax return. That means the owner's gross income becomes \$275,000 – **without regard to whether the owner takes the \$175,000 out of the company – which owners usually don't do – at least not entirely.** So, what's this family's income for “consumption purposes”? That would be far less than the \$100,000 gross income – yet the gross income is \$275,000.

The lesson learned here is that lower tax rates provide this owner incentive to leave dollars in the company to create growth which creates jobs. **This is a very realistic and common scenario, but we usually don't see it presented in this fashion. Do you suppose Obama is starting to realize this idea may be gaining traction?** I don't think so, but some of the progressives in Congress think he is changing his stripes out of convenience, and they are angry!

Mallard Fillmore by Bruce Tinsley



This Is Not a Tax Cut!

This legislation merely **maintains** current tax rates. **IT IS NOT A TAX CUT!** ‘Nuf said on that.

Who Pays Taxes? And How Much?

Most of those targeted by the democrats fit the category that I describe as “moderately affluent.” Only a small minority of the “rich” really are the “super rich” that most people have in mind when the democrats are debating in Congress. In fact, according to a recent report I found, **just a few hundred thousand taxpayers earn more than \$1 million a year.** But whatever the number, the democrats are trying to paint all of the upper middle class and the “moderately affluent”, like those in the example above, with a broad brush of “wicked, evil, mean, bad and nasty.” **This is truly class warfare and a war on profits.**

Consider:

- The top 1% of income earners account for 38% of federal income tax receipts.
- The top 5 % pay almost 60% of federal income taxes.
- The top 50% pay almost all federal income taxes.
- Almost 50% of Americans pay no federal income tax. And be assured that this does not reflect just a bunch of rich people avoiding taxes. This is due to the lower income tax filers falling below the income level required to pay tax.
- **It seems obvious to me that a large percent of the middle class pay no taxes.**

The tax rates are indeed progressive! If “almost 60%” of the tax receipts is too low for the top 5% of earners to pay, then what portion should they pay? If “almost all” of the taxes are paid by the top 50% of earners, and if that’s not enough, what would be enough? Perhaps they should pay “more than all” of the taxes. **Do you see how foolish it becomes if one carries a naïve idea to its absurd conclusion? I’ll concede a progressive tax rate, but shouldn’t all Americans pay something – even if it’s only “a few bucks”?**

Obama Has Even Conceded Something!

It must be said that in aggressively selling his negotiated bi-partisan tax rate proposal, President Obama was forced to back off of some of his ideology and admit some facts (whether he wanted to or not). Much of his agenda is promoting his concept of “fairness,” which really means moving toward total equality. (I like the word egalitarianism, don’t you? It sounds so elite.) In effect, Obama had to whisper (but he whispered assertively and with conviction) that this bi-partisan proposal is “stimulative” – even the portion relating to the higher income levels. Why could he say that? Because it’s true and he knows it! He really has admitted something that, after the smoke clears, he may have to discreetly “reel back in.”

That’s all for now. This is fun! I wonder what’s next?