**Raising Tax Revenue Without Reducing Investment or**

How to have your cake and eat it too.

Whether it’s talk of balancing the federal budget or debate over raising the federal debt ceiling President Obama and Congressional Democrats want to raise taxes on the wealthiest Americans and Republicans do not, at least in a sluggish economy (or any other time for that matter).

As a matter of economic fact it is possible to raise tax revenue on the wealthiest while keeping (or even lowering) their tax rate. Efforts to raise tax revenues by increasing tax rates could very well prove counterproductive.

Increasing the highest tax rate has the unfortunate side effect of lowering the after-tax rate of return on invested capital. When after-tax returns fall there is less spending on capital (job creating) investment projects. In effect, such a policy amounts to ‘throwing the baby out with the bath water’ or, if you wish, ‘strangling the goose that lays golden eggs.’

The wealthiest can be made to pay more tax revenue without endangering capital investment and future economic growth by simply removing or limiting all permissible forms of lowering their taxable income, i.e., deductions and exemptions. Such a policy would raise their average tax rate while leaving their marginal tax rate intact. *It is the marginal tax rate that impacts decisions to invest. As long as the highest marginal tax rate remains constant there is no disincentive to invest even if investors are paying more in terms of tax revenues.* Under such a policy it may even be possible to lower the marginal tax rate and still raise tax revenue provided sufficient deductions are eliminated.

The beauty of this policy is that Democrats could brag that they succeeded in having the wealthiest pay more taxes (revenues) and Republicans could brag that they held the line on taxes (rates) for the country’s job creators. To celebrate they could throw a party and have their cake and eat it too.