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Taxes on wealthy lead to pain for all

Written by Kevin Price

"Soak the rich" is a favorite battle cry for politicians seeking reelection and advocates of social justice, but in the end, it creates injustice for all. This will clearly be seen as a consequence of the recent health care bill, as well as with the President's ambitious efforts to dramatically increase the tax on capital gains.

Numerous major corporations have announced projected losses in the hundreds of millions of dollars due to Obamacare. These tax hikes will have an adverse effect on the capital stock and will undermine job creation among small businesses. You would think the Obama administration, which is presiding over the worse unemployment this nation has seen in over a generation, would do everything in its power to keep unemployment down. To look at the obvious consequences of Obamacare, however, one would think that increased job losses is a policy objective. But the damage does not end with the President's ambitious health care agenda, but is also seen in his desire to change the taxes on capital gains.

Pamela Villarreal, a senior policy analyst with the National Center for Policy Analysis, notes that:

- The 2001 Bush tax cuts reduced the lowest marginal income tax rate from 15 percent to 10 percent and the highest from 39.6 percent to 35 percent. This tax situation led to a job creation environment that was one of the best in recent history and brought the US unemployment down to around 5 percent. Simply put, the cost of using an asset got smaller and the profit got higher. This led to business activity taking place that resulted in more jobs and more tax revenue (because revenue comes from business activities that take place, like the selling of assets).
- President Obama proposes to raise the two top marginal rates to 36 and 39.6 percent beginning in 2011 for the highest-income earners while leaving the other tax brackets unchanged. This will be temporary, however and will be followed with additional changes in the brackets and the amount taxed.
- Starting in 2013, Obamacare will impose an additional 0.9 percent Medicare tax on wage income for individuals earning more than $200,000 a year and couples earning more than $250,000.

- To make matters worse, the new law imposes a 3.8 percent Medicare tax on unearned income, such as "rent, royalties, dividends and capital gains for the same high-income earners."
- The Obama administration also wants to increase long-term capital gains tax rates from 15 percent this year to 20 percent in 2011 for the two highest tax brackets, and taxing dividends at ordinary income tax rates for those earning $200,000 a year or more.

So what kind of impact will this have on the most affluent? Villarreal suggests we should "suppose an individual owns $50,000 worth of stock that has accumulated an 8 percent capital gain and 3 percent dividend after one year:"

- By 2013, the tax on the $4,000 gain (just after one year) would be as much as $1,309, compared to $825 if we simply left taxes at the current rate.
- With the current tax rate on capital gains (15 percent), the tax on the sale of $50,000 in stock would be $825, and the after-tax rate of return would be 9.35 percent.
- If President Obama's proposed capital gains and dividends increases of 20 percent go into effect, along with the excessive new taxes that will come with Medicare, the tax bill rises to $1,352 and the after-tax rate of return falls to 8.38 percent (a drop of almost 1 percent).
- For ordinary dividends, a higher marginal tax rate and the new Medicare taxes could nearly double the individual's effective tax rate from 15 percent to more than 29 percent, essentially doubling the tax burden.

The US already has the unwelcome distinction of having one of the highest tax rates of any industrialized country in the world. After Obama's pro-tax, anti-prosperity, agenda, we will likely be the world's number one tax collector among modern countries. For those who are more affluent, this will result in an after tax rate of return on this type of investment that would have the return on the profit be reduced by approximately 10 percent. The ironic result of such is that increasing the capital gains tax could actually lower government tax revenues (as witnessed in the past), because people will hold on to assets in order to avoid the tax. Remember, unlike the vast majority of people who sell things because they need to move, or they need a different vehicle, or there is some other cost driving necessity, the rich simply sit on the asset and wait until the tax environment changes. They can afford to do that and it is in their self interest. For much of the country, however, it leads to the depletion of jobs and even the hope of jobs.

Instead of increasing taxes on wealth creation (e.g., capital gains, taxes on businesses, etc.), this administration should consider dramatically reducing such barriers between people and jobs.