Should Warren Buffett Pay More Taxes?

By John C. Goodman **August 16, 2011**

I hope he doesn't. Here's why.

Writing in *The New York Times* the other day, Buffett claimed that he and others like him pay too little in taxes. As he's said before, he calculates that his tax rate is lower than his secretary's and that's not fair. In his own words:

Last year my federal tax bill -- the income tax I paid, as well as payroll taxes paid by me and on my behalf -- was $6,938,744. That sounds like a lot of money. But what I paid was only 17.4 percent of my taxable income -- and that's actually a lower percentage than was paid by any of the other 20 people in our office. Their tax burdens ranged from 33 percent to 41 percent and averaged 36 percent.

Some have pointed out that Buffett's calculation is off. The money he receives in dividends has already been taxed once at the corporate level. So his personal taxes are the IRS's second bite of the apple.

But for the moment, put aside all notions of fairness — both the unfairness of double taxation and the unfairness of Buffett vis-à-vis his secretary. I want you to consider instead your own self-interest.

You and I should not be indifferent about the taxes Warren Buffett pays. How he is taxed and how much he pays affects our own economic futures. Here's how.

Consider that when Warren Buffett is consuming, he's benefiting himself. When he's saving and investing, he's benefitting you and me. Every time Buffett forgoes personal consumption (a pricey dinner, a larger house, a huge yacht) and puts his money in the capital market instead, he's doing an enormous favor for everyone else. A larger capital stock means higher productivity and that means everyone can have more income for the same amount of work.

So it's in our self-interest to have very low taxes on Buffett's capital. In fact, capital taxes should be zero. That means no capital gains tax, no tax on dividends and profits — so long as the income is recycled back into the capital market. We should instead tax Buffett's consumption.

Tax him on what he takes out of the system, not what he puts into it. Tax him when he is benefitting himself, not when he is benefitting you and me.

So how much does Warren Buffett consume? That's hard to say. But he doesn't seem to live a lavish lifestyle. It's hard to believe he spent seven million dollars on consumer goods last years. As economist Arnold Kling speculated the other day, it's highly likely that Buffet's income taxes are more than 100 percent of what he consumed!

If you're an envious sort, that result may be satisfying. But it doesn't change the fact that the current tax system has everything backward. The taxes are imposed on Buffett's investment income. They are affected not one whit by how much or how little Warren Buffett spends on himself.

What kind of tax system would get the incentives right? Any tax system that taxes consumption, but not investment.

A flat tax, a national sales tax and a value-added tax — at least in their pure forms — would all accomplish the right goal. And contrary to a lot of loose rhetoric, the changeover to a consumption tax is actually "progressive." It would leave after-tax income more equal than it is today!

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