

# Biggest Tax Increase Ever? Part I

Leading up to the November 2006 mid-term elections, there were a lot of scary stories going around regarding how the Democrats would repeal all of the Bush tax cuts if they were to be put into power. Of course, this wasn't just hyperbole, as some of the Democratic candidates were saying they would do so if elected.

Once the Democrats actually gained control of Congress, a funny thing happened. There was a lot less talk about dismantling the Bush tax cuts, and more talk about just tinkering around the edges. How could this be, considering the Democrats and liberal press have been demonizing the Bush tax cuts since 2001?

Then, despite all of the post-election rhetoric, both the Senate and House did in fact pass budget resolutions that would allow all of the Bush tax cuts to expire after 2010. Surprise, surprise - not really. The Democrats did what they usually do. If the Democrats are successful in allowing the Bush tax cuts to expire, it will represent the biggest tax increase in history.

I'm going to attempt to sort out what is really going on in Congress with regard to taxes. I'll also take some time to poke a few holes in the predictions made by Democrats when the tax cuts were enacted, and then next month, I'll provide some statistics about tax receipts and income levels that just might surprise you.

## **Democratic "Tax Reform"**

As a general rule, when the words "Democrat" and "tax reform" are mentioned in the same paragraph, it usually means a discussion of how taxes are going to be increased. That's because the Dems have historically been the party of tax and spend. To be fair, recent years have shown us that the Bush Administration and a Republican-controlled Congress can spend with the best of them, but at least taxes weren't raised correspondingly.

During the months leading up to the November 2006 mid-term election, both sides were discussing the subject of taxes. The Democrats, as usual, were continuing to demonize the Bush tax cuts and vowed to repeal them. Democratic Representative Charles Rangel, now chairman of the powerful Ways and Means Committee, was quoted as saying that he "*cannot think of one*" of Bush's first-term tax cuts that deserved renewal.

The Republicans, on the other hand, were pointing to the beneficial effects the tax cuts have had on the economy, and how reversing them could lead to economic disaster. They used the fear of tax increases as a campaign tactic, but to no avail. The public's dislike for the Iraq war outweighed the concerns about tax increases.

## **Democratic Post-Election Retreat**

As we all know, the Democrats came out victorious in the mid-term elections, taking over both the House and Senate. However, a funny thing happened on the way to actually

flexing their new-found majority muscle. Articles started to surface quoting Democrats as saying they would not reverse the Bush tax cuts.

One such article quoted Democratic Senator Kent Conrad, chairman of the Senate Budget Committee, as saying, "***Tax and spend, tax and spend, tax and spend. We're not going there.***" Other Democratic leaders said they saw no reason to discuss the issue of Bush's tax cuts, as they were not set to expire until 2010. Instead, they said they would concentrate on closing the "tax gap," which can be defined as enforcing compliance with the tax code.

That's not to say that the Democrats didn't have their own tax initiatives. A January 4, 2007 New York Times article indicated that the Dems were interested in preserving middle-class tax cuts like the child tax credit and a reduction in the "marriage penalty." They also say they want to change or eliminate the Alternative Minimum Tax (AMT) - a goal they actually share with Republicans. The problem with repealing this tax is that it would cost a projected \$1 trillion over 10 years.

Another Democratic priority has become the budget deficit. As a result, they have reinstated the pay-as-you-go "PAYGO" (pay as you go) budget rules like the ones that expired in 2002. Under these rules, any increase in spending would have to be matched by comparable spending cuts (or tax increases) elsewhere.

### **Return To Tax-And-Spend?**

Back to the Bush tax cuts. As noted above, despite all of the post-election rhetoric about not touching the Bush tax cuts, both the Senate and House Democrats have recently pushed through budget resolutions that allow these tax cuts to expire after 2010. I should make it clear that the House and Senate budgets do not specifically repeal the tax cuts, they just increase spending while allowing the tax cuts to lapse after 2010.

Some Democrats want to retain some of the tax cuts aimed at the middle class, but the PAYGO rules require them to offset any revenue loss in the budget. This will mean either spending cuts or higher taxes for someone. Others, like Democratic Senate Budget Committee Chairman Kent Conrad indicate that tax money will be found by increasing enforcement and making sure taxpayers file their returns and pay their fair share. However, the Heritage Foundation suggests that relying on more than just a few billion per year from increased compliance seems overly optimistic.

As noted above, the PAYGO rules require any future tax cuts or spending increases to be offset by tax increases or spending cuts elsewhere in the budget. There can be exceptions, but any provision not meeting the PAYGO rules must be approved by 60 votes in the Senate. This would effectively render any future attempt to extend the current Bush tax cuts dead on arrival, since 60% of the Senate would have to agree on just extending the existing cuts beyond 2010.

Don't get me wrong, I'm not necessarily opposed to the PAYGO rules. I believe the federal government (actually, any government body) should live within its means.

However, I also believe that tax cuts are favorable, as we have seen them work under both the Kennedy, Reagan and Bush administrations. It just takes tax cuts longer to work through the economy, so any increased tax revenues may not fall within any particular budget window.

### **Legacy Of The Bush Tax Cuts**

For Democrats to allow the Bush tax cuts to expire ignores a very large reality - the tax cuts worked, as usual! Please note how the tax cuts had helped the economy continue to grow, despite huge negative factors like rebuilding after hurricane Katrina, the war in Iraq, interest rate increases and record crude oil prices.

Adding to that evidence, the Tax Foundation recently released a report showing additional benefits of the tax cuts, including a finding that government benefits received by low-income households far outweigh any taxes that they pay. The Tax Foundation study, entitled "*Who Pays America's Tax Burden, and Who Gets the Most Government Spending?*" lays bare the claims that tax cuts favored only the very wealthy. In fact, this study shows that the current tax code actually redistributes trillions of dollars from wealthy taxpayers to low-income homes.

According to a Tax Foundation press release, an analysis of federal, state and local taxes and government spending showed that the lowest-earning 20% of households received roughly **\$8.21** in government spending for each dollar of taxes paid in 2004. Middle-income households receive approximately **\$1.30** per tax dollar, while the wealthiest households get back only 40 cents on the dollar. Dear readers, this is called wealth redistribution. [Socialistic is another word for it].

Using 2004 income tax data, the latest available, the study points out that about 44 million Americans pay no income taxes at all, while the top 5% paid **57.13%** of the total. IRS data for 2004 further reveal that the top 50% of taxpayers paid **96.7%** of all income taxes, while the bottom 50% paid only **3.3%**. This is a larger share for the top 50% than when I last wrote about it back in 2003 when the 2000 income tax data showed the bottom 50% of taxpayers paid 4% of all income taxes.

It's even more telling when you delve deeper into the IRS data and compare 2004 with 1986, when the top 50% paid 93.54% of taxes and the bottom 50% paid 6.46%. **Thus, over an 18-year period, the share of income taxes paid by those in the bottom half of earned income has been cut almost in half.** But the media almost never refers to this fact.

The significance of the Tax Foundation study is obvious. Liberals have constantly complained that tax cuts favor only the rich. The study shows that low-income households receive far more in benefits than they pay in tax dollars - by a factor of eight to one. And since many lower income households pay no income tax at all, their return is even greater. This study shows that tax cuts, when properly designed, can help the economy and low-income households. (*Continued next month*).

*The below article was written by Gary D. Halbert, president and chairman of Profutures, Inc. Subscription rates for Forecasts & Trends is \$197 for 12 issues and may be obtained by visiting his website at [www.profutures.com](http://www.profutures.com).*