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# *Buffet’s, Romney’s tax bills focus debate on how much rich should pay*

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WASHINGTON — Some of the nation's wealthiest Americans are paying federal taxes at a rate lower than hundreds of thousands of middle-class wage earners thanks to a system that rewards investment over sweat labor.

The debate over tax rates has heated up over the past few weeks as a result of the stories behind two multimillionaires — Nebraska investor Warren Buffett and Republican presidential candidate Mitt Romney.

Buffett, one of the nation's richest men, maintains he pays a lower effective tax rate — 17.4 percent — than his secretary, who earns about $60,000 a year and is taxed at an effective rate of 36 percent, according to ABC News. That claim apparently takes into consideration the federal income tax and other levies, such as the FICA tax that funds Social Security.

Buffett asserts the rate discrepancy isn't fair and that wealthy individuals should pay a rate higher than a middle-class secretary.

That admission was picked up by President Obama, who has called for what he has come to term "the Buffet rule" — the wealthy should pay at least the same tax rate as those in lower brackets. The tax plan would apply to individuals earning more than $1 million per year, about 450,000 Americans.

"If you make more than $1 million a year you should not pay less than 30 percent in taxes," the president said Tuesday during his State of the Union address. "And my Republican friend (Sen.) Tom Coburn (of Oklahoma) is right — Washington should stop subsidizing millionaires. In fact, if you're earning a million dollars a year, you shouldn't get special tax subsidies or deductions."

"Now, you can call this class warfare all you want," Obama said, addressing his critics. "But asking a billionaire to pay at least as much as his secretary in taxes? Most Americans would call that common sense."

As for Romney, the former Massachusetts governor released his tax returns for the past two years under pressure from his GOP rivals. It revealed that he earned $40 million and paid taxes at an effective rate of about 13.8 percent — well below the rate paid by most Americans who earn enough to qualify to pay income taxes.

It appears the American public is siding with Obama. A CBS News/New York Times poll released Tuesday showed that 52 percent of Americans say capital gains and dividends should be taxed at the same rate as income earned from work because the current policy increases the federal deficit and is unfair to people who don't have money to invest. Thirty-six percent approve of the current policy of taxing capital gains at a lower rate because it encourages investment.

Obama attributed such disparities to "loopholes and shelters in the tax code." In reality, most of the difference can be attributed to the manner in which the tax code handles capital gains, loosely defined as a profit that results from investments in items like stocks, bonds or real estate that exceed the purchase price.

Romney, through Bain Capital, the financial services and investment management firm he once led, and Buffett earn significant amounts of income through capital gains, which are currently taxed at a maximum federal rate of 15 percent. Meanwhile, individuals who receive earned income, such as from wages or salary, can pay an income tax rate as high as 35 percent.

Romney, for instance, reported earnings of $21.6 million in 2011 — $20.8 from investment income that is taxed at the 15 percent rate established for most dividends and long-term capital gains. Romney gave $3 million in charitable contributions — mostly to the Mormon church — which provided him with a significant deduction. In the end, his effective income tax rate was 13.8 percent.

According to the Congressional Research Service, about 94,500 of the nation's millionaires pay a tax rate of less than 26.5 percent. About 10.4 million Americans who earn less than $100,000 annually pay a tax rate higher than 26.5 percent. And the Internal Revenue Service reports that 1,470 households had incomes of more than $1 million in 2009 but paid nothing in federal income taxes.

The wealthy still pay cumulatively more in taxes than middle income wage earners, but Seth Hanlon, Director of Fiscal Reform at the Doing What Works project at the Center for American Progress, said the claim is meaningless.

"The point is not to ensure that rich people on average pay higher taxes than middle-class people on average — of course they do and of course they should," he said. "The point is to ensure that all households with incomes above $1 million pay at least what middle-class families are paying."

Roberton Williams, a senior fellow at the Urban-Brookings Tax Policy Center, said tax rates on capital gains have fluctuated over the past hundred years. Those rates have occasionally matched the income tax rates paid by normal wage earners but they are more often substantially lower. The current 15 percent is "lower than at any time since the depression." If Congress doesn't change the law, the expiration of the Bush-era tax cuts at the end of 2012 and imposition of taxes associated with the 2010 health care legislation will boost the maximum tax rate on capital gains to 25 percent in 2013.

"You have to go to the extreme top end of the income spectrum in order for capital gains realizations (income) to really push down overall effective tax rates," said Chris Edwards, director of Tax Policy Studies at the Cato Institute, a

Libertarian think tank. "The IRS publishes data for the 400 highest-income taxpayers. For these taxpayers, the average effective income tax rate in 2008 was 18.1 percent."

Edwards argues that capital gains have been taxed differently from other types of income since the inception of the federal income tax in 1913 "for some very good reasons."

The biggest issue is double taxation — corporate profits are taxed at the business level and then again at the individual level by taxes on dividends and capital gains. Providing a lower rate for dividends and gains at the individual level, Edwards noted, is one way to partly alleviate this problem.

The U.S. is not alone in the way to handles capital gains. According to Edwards, virtually all high-income nations recognize that capital gains are different and that special rules are needed. New Zealand and the Netherlands have a zero tax rate on capital gains.