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Tax cut debate includes selective stats

Neither side completely right or wrong. Congress unlikely to pass any tax bill.

By Jack Torry, Washington Bureau
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WASHINGTON — From now until the election, Republicans and Democrats will engage in a bitterly divisive debate about whether simple fairness requires the wealthy to pay higher taxes on their income and investments.

Here’s what voters need to know: To make their case, both parties are relying on a selective use of statistics so neither side is completely right nor wrong.

For President Barack Obama, who has proposed extending an array of tax cuts for families earning less than $250,000 a year, the increase on the wealthy would be relatively small, easily affordable, and return much of the tax code to the 1990s level when the economy boomed.

By contrast, presumptive Republican presidential nominee Mitt Romney and his Republican congressional allies say Obama’s plan would be an $800 billion tax increase during the next decade, discourage investment, and cripple thousands of small companies at a time when they are being counted on to drive the nation’s recovery.

“Both sides are saying some misleading things, but the things the president is saying are more troubling,” said Alan Viard, a former professor of economics at the Ohio State University and now a scholar at the right-leaning American Enterprise Institute in Washington.

But Michael Linden, director of tax and budget policy at the Democratic-leaning Center for American Progress in Washington, said the president’s plan makes economic sense because the government can divert tax dollars from the wealthiest people and spend it on construction projects, which can jolt the sluggish economy.

In addition, Linden argued, Obama's tax plan buys time until next year when Congress can "have a real debate on tax reform. We'll start from scratch and do something better."

Here is the reality: Obama's plan would raise taxes on some small businesses, increase taxes on capital gains to the highest level since 1997, and dramatically hike taxes on dividends.

But the vast majority of small companies in the United States would not pay higher taxes and families earning as much as $300,000 a year would face only a token tax hike.

Much of this debate will be for show. With the House controlled by the Republicans and the Democrats holding a slim advantage in the Senate, analysts from both parties say it is highly unlikely any tax bill would win congressional approval by November.

"The president doesn't have the support in the House and the Senate for his proposal," said Ted Hollingsworth, a Washington lobbyist and former chief of staff to former Sen. George V. Voinovich, R-Ohio. "I don't believe he would get 50 votes in the Senate and it would be overwhelmingly rejected in the House."

"I think they believe it's good politics and the president fundamentally believes the most important issue is not growth, but income inequality," Hollingsworth said.

Deadline looming

At stake are a series of tax reductions approved in 2001 and 2003 by Congress and signed into law by former President George W. Bush. They included reducing income tax rates for all Americans, slashing taxes on married couples, capital gains and dividends, while increasing the child tax credit for families.

All were scheduled to expire at the end of 2010. But last year, Obama and Congress agreed to extend them until the end of this year, with both sides agreeing it made little economic sense to raise taxes while the nation was in the throes of a deep recession.

Last week, Obama outlined his new approach, insisting that "our prosperity has always come from an economy that's built on a strong and growing middle class."

Under Obama's plan, the tax cuts would be extended for all American families who report taxable income of less than $240,800 a year — roughly $250,000 in adjusted gross income. Families with taxable incomes greater than $240,800 would see their income tax rates rise from a low of 33 percent to a high of 39.6 percent.

In addition, capital gains, which are the profits from the sale of real estate and stocks, would be increased for the wealthy from 15 percent to 23.8 percent. Taxes on dividends paid by corporations to their stockholders would leap from 15 percent to roughly 40 percent.

The proposal, while taking a large bite from families with incomes greater than $500,000, would have a minimal effect on many upper middle income families. A family with a taxable income of $270,000 would only pay a higher rate of 36 percent on the last $30,000 of their income, for example. The first $240,000 of their income would be taxed at the current rates.

In addition, Obama argued that "these tax cuts for the wealthiest Americans are also the tax cuts that are least likely to promote growth. Linden said that while "middle income people spend all their money" every year, the wealthy "don't spend every dollar they earn and don't plow all those dollars back into useful investments."

However, conservative economists such as Chris Edwards at the CATO Institute in Washington describe that argument as "complete nonsense. I think it's ridiculous to say they sit on their money."

Instead, he cited wealthy financiers such as Paul Allen, a co-founder of Microsoft, who steers a large chunk of his fortune into real estate, media, sports and technology firms.By raising taxes on dividends, conservative economists argue that large corporations may find it cheaper to borrow money — which they can deduct — as opposed to financing expansions through the sale of stock. But that could lead to corporations taking on unhealthy doses of debt.

"It creates a larger distortion in terms of how corporations finance themselves and makes debt financing much more attractive," said Lee Ohanian, a professor of economics at UCLA. "We've gone through a recent period where some kind of debt financing didn't work so well for the economy."

Mixed message about effect on businesses

The loudest argument between the two parties is the impact Obama's plan would have on small companies. Because a sizable number of people own or partially own their own companies — both large and small — they pay federal taxes through the individual rates as opposed to the 35 percent corporate rate.

While Obama is correct when he says only 3 percent of these companies — known as S corporations — would pay higher taxes, as many as 750,000 firms would have a tax increase. According to the congressional Joint Committee on Taxation, those 750,000 firms account for one half of the $1 trillion of positive business income reported on individual returns.

In addition, not all of those 750,000 firms are small. The Joint Committee on Taxation concluded that in 2005, nearly 13,000 S corporations and 6,658 partnerships reported annual receipts of more than $50 million.

"There are lots of mom and pop organizations that aren't going to be impacted,'' Ohanian said. "But those are not the job creators. The job creators are the businesses that are small and taking off ... they are going to be impacted.''

But Linden said Americans would "basically find it's a small number of businesses" that would be taxed at a higher rate.

"The vast majority of small businesses will not even notice," he said.