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Why high taxes will never soak rich

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Whether it's through the Buffett Rule, higher income-tax rates or double taxation of dividends and capital gains, President Obama often demands that "rich" taxpayers and big corporations send more money to Washington.

But as Americans pay their taxes by today's deadline, we might note that trying to get more money from upper-income taxpayers is like playing whack-a-mole. So long as tax rates are high, rich people will figure out ways to protect their income.
It doesn't take a tax genius; any rich person can make a phone call or hit a few computer keys and shift his or her investments to tax-free municipal bonds. It's not good for the economy when capital gets diverted to help finance the excess spending of Detroit or California, but it's an effective way of stiff-arming the IRS.

Or the rich can play the green-energy scam, getting all sorts of credits to offset their tax liabilities. That's one way General Electric made lots of money and kept it all for shareholders.

Statists often will respond by arguing that we should reform the tax code. But instead of a flat tax, which would rid us of loopholes and would lower tax rates, they just want to end the loopholes and keep tax rates high — or raise them even higher.

Even if lawmakers abolished the various tax-code distortions, they might still be disappointed. The one sure way for rich people to lower their tax bills is by generating less income.

Here's a quick economics lesson for the class-warfare crowd: When the government taxes income, it raises the price of work compared to leisure. And because the tax code penalizes capital gains with higher rates, it also raises the price of saving and investment compared to consumption.

Yet work, production, saving and investment are how we generate national income, so it doesn't make sense to discourage taxable income with higher tax rates.

This isn't some sort of modern-day revelation. Andrew Mellon, a Treasury secretary during the 1920s, noted that "the history of taxation shows that taxes which are inherently excessive are not paid. The high rates inevitably put pressure upon the taxpayer to withdraw his capital from productive business."

Unlike the rest of us, the rich have a great ability to alter the timing, amount and composition of their income. That's because, according to IRS data, those with more than $1 million of adjusted gross income get only 33 percent of it from wages and salaries. The super-rich (those with income above $10 million) rely on wages and salaries for only 19 percent of their income.

In 1980, when the top tax rate was 70 percent, rich people (those with incomes of more than $200,000) reported about $36 billion of income; the IRS collected about $19 billion of that amount. So what happened when President Ronald Reagan lowered the top tax rate to 28 percent by 1988? Did revenue fall proportionately, to about $8 billion?

Folks on the left thought that would happen, complaining that Reagan's "tax cuts for the rich" would starve the government of revenue and give upper-income taxpayers a free ride.

But if we look at the 1988 IRS data, rich people paid more than $99 billion to Uncle Sam. That is, because rich taxpayers were willing to earn and report much more income, the government collected *five times* as much revenue with a lower rate.

To be sure, many other factors helped account for the explosion of taxable income, including inflation, population growth and other pro-growth policies. So we don't know whether the lower tax rates on the rich caused revenues to merely double, triple or quadruple.
But we *do* know that the rich paid much more when the tax rate was much lower.

Now Obama wants to run the experiment in reverse. He hasn’t proposed to push the top tax rate up to 70 percent, thank goodness, but the combined effect of his class-warfare policies would mean a big increase in marginal tax rates.

That might be good for workers in China, India or Ireland, because American jobs and investment would migrate to those places. But it’s not the right policy for the United States.

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