Here Come the Taxes: In Every Aspect of our Lives

Brenda has raised seven children and still has two teenagers living at home. One is still in high school, while the other, a recent graduate, has been able to find only a part-time job. Her husband's company hasn't given a pay raise in three years and Brenda supplements the income from her own part-time job by waitressing at a local restaurant two or three nights a week. Family vacations went out of the household budget years ago, and the minor luxury of eating out once a week has been supplanted by an occasional sending out for pizza. Faced with rising prices at the gas pump, the supermarket, and various points in between, Brenda (not her real name) is used to finding ways to scrimp and save to feed her family.

"I use cheaper cuts of meat, or I buy stuff when it's on sale, or I buy in bulk," she said. "You have to really be on your toes and be aware of how much you're spending." She wonders how retirees on Social Security are surviving, but concludes, "Working families are not much better off."

The budget squeeze Brenda describes is common to millions of American families trying to earn and save enough to pay for the necessities of life. Yet unless Congress and the White House can agree by year's end on an extension of tax cuts that have been in place for most of the past decade, workers will see an increase in the taxes taken out of their paychecks next year and a loss in the amount they claim for deductions when it comes time to pay their 2013 taxes.

Taxmageddon

The increases have been dubbed "Taxmageddon," named after the Battle of Armageddon, foretold in the Book of Revelation, that is to occur at the end of this age. Chances are the world won't come to an end on New Year's Day, 2013, but for millions of Americans, it may become a more expensive place to live in. The tax hikes, scheduled to take effect on January 1, will take their toll on families at all economic levels, at an average of $3,500 per household, according to the Tax Policy Center (TPC), a joint project of the Urban Institute and the Brookings Institution. The after-tax purchasing power of low- and middle-income Americans will be diminished, along with the capital available for investment from high-end earners. Some economists are warning that the combination of tax increases and spending cuts required by the sequestration provision of the Budget Control Act of 2011 could knock an already weak economy into another recession, adding to the ranks of the 12 million Americans officially counted as unemployed and the millions more who can find only part-time work, or have given up looking altogether.

"It would probably lead to a recession early next year," predicted Doug Elmendorf, director of the Congressional Budget Office (CBO), unless Congress acts to halt the drive off what some are calling the "fiscal cliff."

"You can call this a fiscal cliff," Sen. Orrin Hatch (R-Utah), ranking Republican on the Senate Finance Committee, said earlier this year. "You can call it Taxmageddon, as others have done. Whatever you call it, it will be a disaster for the middle class. And for the small businesses that will be the engine of our economic recovery."

And to All a Tax Hike

The "holiday spirit" may be strained when the tax hikes, affecting some seven out of eight households, go into effect on January 1. Household incomes of between $108,226 to $143,000 will be taxed an additional $6,359, according to the Tax Policy Center. At the lower end of the scale, those with incomes of less than $20,113 a year will endure a tax hike of $412. The "marriage penalty," resulting from narrower tax brackets for married couples, will return on January 1, while the child tax credit will be cut in half, from $1,000 to $500 per child. The two-percent payroll tax cuts, the earned income tax credit, and the childcare tax credit are among the tax breaks scheduled to expire at the end of the year. Education tax credits, a number of business deductions and credits, and deductions for state and local sales taxes are all scheduled to fall by the wayside.

Even the silver lining in the dark fiscal clouds over the nation is likely to be proven a mirage. The Tax Policy Center forecasts a $536 billion shower of new revenue for the federal government next year if the tax cuts aren't extended, a windfall that would cut the more than $1 trillion-a-year deficit in half. The policy center's forecast is higher than the Congressional Budget Office's projections, but even the CBO estimate may turn out to be unduly optimistic if the economy tumbles into a recession. More people out of work will mean less revenue from taxes and more money spent on unemployment compensation and other forms of assistance.

"For a government that raises about $2.5 trillion a year in revenue now, this would be a very large tax increase — about 20 percent or more," Donald Marron, director of the Tax Policy Center, told *Business Insider*. For Eric Toder, a senior fellow at the Urban Institute, "part of the surprise was to me was how big the tax increase was, it's just a huge, huge number."

Paying "A Little More"

President Obama has said repeatedly he would sign a bill to extend the tax cuts only if it excludes households with incomes of $250,000 or more, or individuals earning $200,000 and above. Those in the top tax bracket can afford to "pay a little more," he insists, as they did in the '90s when America prospered and 20 million new jobs were created. But the economic boom of the Clinton era was the result of a number of factors unrelated to tax policy. The end of the Cold War resulted in a decade of lower military expenditures, the commercialization of the Internet fueled the expansion of the high-tech industry, and low interest rates and liberal lending policies created the "bubble" in the housing market that finally burst in 2007-08, triggering the collapse of much of the nation's finance industry.

And the "little more" that those in the upper income levels would pay by a return to the rates that preceded the Bush tax cuts would be a significant amount. The tax bite on a married couple with a combined income of $250,000 would increase from 33 to 36 percent, or from $83,000 to $90,000, not counting deductions. The "top one percent," those earning $500,000 or more, would see an average tax increase of $120,537 a year, according to the TPC figures, though the average is skewed by the increase on the top tenth of one percent, with earnings of $2.66 million or more a year. That group will be looking at an average increase in their tax bill of $633,946, when the high-end portion of the tax cuts are eliminated and the reductions on long-term capital gains, dividends, and estate taxes expire.

The increased taxes on the high earners would bring an added $44 billion to the federal treasury, the TPC study anticipates, though revenue from higher tax rates often proves elusive. The rich can afford to hire accountants learned in the mysteries of the tax code and able to steer money through the maze of variable rates, deductions, and exemptions to reduce tax liability. While competing studies offer different scenarios on the effect of the higher rates, the uncertainty is itself a barrier to the kind of investment that will create jobs and spur economic growth.

"When you're unsure about the future you freeze," said Bill Dunkelberg, chief economist of the National Federation of Independent Businesses. "That's what's happening to consumers and small business owners. And that's why economic growth is continuing to be slow."

Capital Gains and Dividends

The tax on capital gains for individuals with incomes of $200,000 or more, or household incomes of $250,000 or more, will go from 15 to 20 percent at year's end. Dividends for that group, now taxed at 15 percent, will be taxed as ordinary income at the top rate of 39.6 percent. Both would be subject to a 3.9 percent surcharge under the Affordable Care Act (see "ObamaCare" below). Last May the CEOs of 18 major companies — including Duke Energy, Dominion Resources, United Parcel Service, Windstream, and Verizon — published an open letter to Treasury Secretary Timothy Geithner as an opinion article in Politico. In it, they urged the secretary to reconsider the administration's stand in defense of the higher rates. "We believe the administration's proposal will limit corporations' ability to raise new capital and will undermine economic growth," they wrote, adding:

> Lower dividend yields and higher taxes on dividends would also hurt economic security for taxpayers at every income level — particularly seniors, who rely heavily on investment income to make ends meet.

The threat of looming tax increases on dividends and capital gains could also increase volatility in the stock market this year. Investment advisers are already cautioning clients to consider potential tax law changes for dividends and capital gains while making investment decisions.

An Ernst & Young study for the Alliance for Savings and Investment found the new rates will put the integrated tax rate (taking into account state and local taxes) for capital gains at 56.7 percent, and at 68.6 percent for dividends, "significantly higher than in all other countries," the CEOs said. That, together with the high U.S. corporate tax rate, could put the United States at a competitive disadvantage, they warned.

ObamaCare Taxes

Then there will be the tax increases that will be mandated under the Patient Protection and Affordable Care Act (ObamaCare). While the 3.9-percent surtax will apply only to incomes above the $200,000/$250,000 threshold, other new taxes will be imposed regardless of income level. They include:

• Flexible Spending Accounts Cap — Currently there is no limit on how much you may deduct from your taxable income for money set aside for medical expenses. Next year the cap will be $2,500.

• Deductions for Medical Expenses — Under existing law, taxpayers may deduct medical expenses that exceed 7.5 percent of their adjusted gross income. On January 1, the deduction will only apply to expenses exceeding 10 percent of AGI.

• The Tax Penalty for Non-medical Withdrawals from Healthcare Savings Accounts — This will double, from 10 to 20 percent.

• A Tax on Medical Devices — Starting in 2013, manufacturers of medical equipment will pay a 2.3-percent excise tax on the sale of medical devices costing more than $100. That will likely raise the costs of medical procedures.

Those are in addition to "ObamaCare" taxes already in effect. The "tanning tax" — a 10-percent levy on indoor tanning services — has been in place since 2010. The "Medicine Cabinet Tax," eliminating the ability to buy over-the-counter medicines from a pre-tax Flexible Savings Account, took effect last year. Still ahead is the penalty (ruled a tax by the Supreme Court) for not buying health insurance. That starts in 2014. And there will be a new tax on "Cadillac" healthcare plans, where employees will be required to pay a 40-percent tax on what their employer pays for healthcare plans that cost over $10,200 a year for individuals and $27,500 for families. That won't take effect until 2018, perhaps as a concession to unions that have the "Cadillac" plans as part of their collective bargaining agreements.

Spending Cuts

Last year's Budget Control Act, raising the debt ceiling $2.1 trillion, included a sequestration provision to take effect at the beginning of 2012 unless Congress enacted the recommendations of a bipartisan "super committee" established to find ways to reduce the national debt by $1.2 trillion over the next 10 years. The 12-member committee, co-chaired by Sen. Patty Murray (D-Wash.) and Rep. Jeb Hensarling (R-Texas), reported back to Congress that it was unable to reach a consensus by the November 23 deadline.

That was one year ago. Congress in this election year was not about to tackle taxing and spending decisions it has already handed off to a super committee that punted it back. As a result, the "across the board cuts" to more than a thousand government programs are to begin on January 1, 2013. Social Security, Medicaid, and veterans benefits are exempted, however, and cuts to 90 percent of Medicare spending would be limited to two percent. The law also exempts pay for both civilian and military federal employees. While the cuts are to apply equally to security (mainly the departments of Defense and Homeland Security) and non-security spending, the caps are remarkably flexible. "The law allows for adjustments to the caps when appropriations are provided for certain purposes," according CBO Director Elmendorf. Funding for the war in Afghanistan, for example, is not included, and funding for "overseas contingency operations," disaster relief, and other emergency requirements would also result in increases in spending caps.

Most of the spending "cuts" would take place over a 10-year span and would in reality be reductions in the rate of *increase* in federal spending. The tax increases, on the other hand, would be real cuts in the take-home pay of most people still fortunate enough to have a job. Americans, meanwhile, continue to see their real incomes decline and their purchasing power diminished as the Federal Reserve increases the supply of money in an effort to keep the debt-laden economy from collapsing.

The Bipartisan "Debt Bomb"

One question seldom asked and almost never answered is where, in a nation theoretically governed by a Constitution of delegated powers, does Congress find the authority to fund more than 1,000 government programs?

"Both parties have equally participated in abandoning the limited role of the federal government," Sen. Tom Coburn (R-Okla.) said in a recent interview with Reason.com editor Nick Gillespie. "We spent money we didn't have on things we don't absolutely need, which refers back to the enumerated powers listed in Article I, Section 8 of the Constitution." Coburn, author of *The Debt Bomb*, cited the $2 trillion the federal government has spent on education since Congress passed the first Elementary and Secondary Education Act in 1965, along with $18 billion a year that is being spent on job training programs. “Why do we have 90-some teaching programs?” Coburn asked. “Where in the world do we get the authority to have teacher training programs run by the federal government?”

Coburn has also parted company with many of his Republican colleagues on military matters, having said in 2008 that the Iraq War was a mistake, and in 2010 calling for a freeze on defense spending. “What Eisenhower said about the military-industrial complex is true,” he said in his Reason.com interview. “My foreign policy is limited in its expertise, but I actually believe the Constitution. I actually don’t believe we ought to get involved in things unless we have a direct national security issue.”

Other Republicans have been warning that a $600 billion cut from the sequestration, added to an already scheduled cut of $500 billion, will trim military spending by $1.1 trillion over the next 10 years. Sen. Lindsey Graham (R-S.C.), for example, told the NBC affiliate in Augusta, Georgia, that the cuts would “devastate the department of defense” and force the kind of troop reductions that could put Augusta’s Fort Gordon out of business.

Debt and Defense

Not all military spending is genuinely for the nation’s defense, however. Arguments for maintaining a given military base are, more often as not, based more on the military and civilian jobs the base supports, rather than real defense needs. While some bases are no doubt needed, the dollars supporting jobs in any government program, military or civilian, are dollars that are taken through taxation that might otherwise be creating and sustaining jobs in the private sector. Or they are additional dollars printed by our Treasury Department or borrowed from abroad, diminishing the value of our money, while adding to the debt crisis.

And with a military budget that has doubled since 2000, American security appears not to be suffering from a lack of spending. It is, however, threatened by our mounting debt. “I think the biggest threat we have to our national security is our debt,” said Admiral Mike Mullen, chairman of the Joint Chiefs of Staff from 2007 to 2011.

The United States has no shortage of weapons needed for our defense. The inventory includes 11 aircraft carriers, with plans for a twelfth. “Do we really need 11 carrier strike groups for another 30 years when no other country has more than one?” asked Robert Gates, who served as secretary of defense under both George W. Bush and Barack Obama. The Navy has 280 ships and submarines patrolling the seas, while our Air Force dominates the skies. The Pentagon spends more on research and development alone, Christopher Preble wrote in his 2009 book, *The Power Problem*, “than Germany, the United Kingdom, France, Russia, or Japan spend on their entire defense budgets.”

In addition to our trillion-dollar wars in Iraq and Afghanistan, America has accrued much of its debt by maintaining a force of a quarter of a million U.S. military personnel in more than 100 countries around the world. Nearly 60 years after the end of the Korean War, we still have nearly 30,000 U.S. troops on the peninsula to defend South Korea, which has twice the population and roughly 20 times the GDP of its impoverished neighbor to north. Sixty-five years after the end of World War II, we still have military bases in Germany and Japan. The nations of the European Union combined have a larger population and GDP than the United States, but still rely on America for the security of the continent.

“By a 2-1 margin, 55 to 28 percent,” reports pollster Scott Rasmussen, “voters think we should withdraw our troops from Europe and let Europeans defend their own land.” In his book, *The People’s*

Money, Rasmussen noted, "the political elite has still not convinced the American people that we should police the world. Fifty-five percent of voters nationwide believe military strategy should be focused narrowly on defending America and its interests. Only 34 percent think the military's strategy should be the maintenance of worldwide stability and peace." Though Rasmussen himself regards the late Senator Robert Taft (R-Ohio) as an "isolationist," he concedes that most Americans today would probably agree with Taft's assertion that "war should never be undertaken or seriously risked except to protect American liberty."

Reading, but Not Heeding,
the Constitution

Yet none of these positions is reflected by the leaders of the nation's two major parties or the policies they pursue. The Tea Party uprising resulted in a turnover in the House of Representatives in the 2010 elections, with Republicans regaining control from the Democrats. Members of both parties began the new session in January 2011 by taking turns reading aloud the Constitution of the United States in the House Chamber. They have, for the most part, spent the next two years ignoring it, voting appropriations for countless programs for which there is no constitutionally authorized federal role. At the same time, House Republicans managed to pass a spending plan that will, in theory, lead to a balanced budget — in 2040.

"Low taxes are the result of low spending" was the motto of the late New Hampshire Governor Meldrim Thomson, Jr. Members of Congress have other ideas, however, and they will likely come up with schemes to paper over the growing debt crisis and postpone the inevitable. While Congress continues to, as Coburn put it, "spend money we don't have on things we don't absolutely need," millions of Americans are stretching their after-tax dollars for things they absolutely do need.

"You need to have shelter, food, clothing and transportation to and from work," said Brenda, the part-time waitress and full-time mother. "And all of those commodities are going up and up because the dollar's been devalued. So now we're looking at squeezing more out of working class and middle class families." The political class in Washington, she believes, is insulated from it all. "So many folks are furious with the way things are going," she said. "I guess they can't hear us down there."