HOW AMERICA WAS TRICKED ON TAX POLICY

Secrets and Undisclosed Practices

We don’t pay taxes. Only the ‘little people’ pay taxes.

- Leona Helmsley

Dr. Bret N. Bogenschneider, PhD, JD, LLM
HOW AMERICA WAS TRICKED
ON TAX POLICY
HOW AMERICA WAS TRICKED ON TAX POLICY

SECRETS AND UNDISCLOSED PRACTICES

DR. BRET N. BOGENSCHNEIDER

“We don’t pay taxes. Only the ‘little people’ pay taxes.”

Leona Helmsley
INTRODUCTION: THE CLASSIC DECEPTIONS IN TAX POLICY

You’ve probably been told many things about tax policy:

• That the wealthy pay a surplus of tax into the system and that workers somehow draw out these funds disproportionately to receive a net benefit.
• That the economy will grow quickly because of tax cuts for large corporations that supposedly give those companies enough free cash to make investments into new business lines.
• That if the wealthy were asked to pay taxes they might simply pack up and leave, creating a loss to the economy.

Of course, none of these claims are true. The truth is, what you have been told about tax policy is a trick designed to deceive you into working ever longer hours and paying taxes at ever higher effective rates. Many of these and other ideas about taxes and tax policy, especially those that you hear on television, are inconsistent with each other and make little or no logical sense. For example, if the first idea were true, that the wealthy pay copious amounts of surplus tax into the system, then it cannot also be true that the wealthy would leave if they were forced to pay any tax.

At this early stage, you should be at least suspicious that something is amiss with what you’ve been told about tax policy. The truth is that tax policy is formed by and through a series of deceptions. The foremost deception, which is the premise of both economic and philosophical thinking on taxation, is that it is always better for society that workers pay the bulk of taxes and that the wealthy and large corporations pay as little as possible. Economists claim that this type of tax policy is efficient for society. However, any supposed efficiency gains could arise only if the wealthy have very special plans for capital that they could achieve if they were not required to pay taxes. In fact, there are good reasons
to believe that workers are better able to efficiently allocate small amounts of capital they have earned through work. The act of engaging in productive work is strong evidence that a person should be able to find a productive use for some capital. This means that it would be better and more efficient for society if taxes on the persons that engage in productive work were reduced from current levels so workers could invest their own capital, derived from their own work, in various productive pursuits. The productive pursuits of workers might be expected to yield efficiency gains for the economy including enhanced small business formation. Such productive efforts are encouraged where workers are not forced to pay nearly all of their surplus capital over to the government in the form of high rates of labor taxes and small business taxation. Some might even go further and call that a “fair” approach to tax policy.

Notably, the Social Security Trust Fund, as accumulated over the years from withholding taxes on prior generations of workers, was used to fund the federal budget, until even it ran out of money. All the while, politicians claimed, preposterously, that workers don’t pay taxes and that the wealthy pay a disproportionate amount of taxes because of the progressivity of the income tax system. Even a cursory glance at the federal budget reveals that such a claim is sheer nonsense, however. If we look to cash flows, the reality is that workers remit the bulk of the taxes through income taxes, employment taxes, sales taxes, gasoline taxes, property taxes, excise taxes, governmental fees for licenses and on and on. Since most of these tax types are either regressive (such as employment taxes) or not progressively indexed (such as property taxes), the overall system of taxation is regressive as workers pay a higher proportion of their earnings into tax types other than income taxes. The wealthy do not pay proportionate amounts largely because capital income is not taxed currently and the non-indexed tax types, such as sales taxes, are simply not as material to the wealthy in dollar terms as they are to workers. If we apply a more reasonable accounting method to tax policy and take into accounting holding gains on capital assets as tracked by the Federal Reserve, for example, then the effective tax rates on the wealthy are about one-third (1/3rd) those paid by the working classes. As will be explained in further detail later, it turns out that effective tax rates are more important than statutory tax rates or marginal tax rates and even the underlying methods of calculating an effective tax rate have been manipulated to deceive working taxpayers.

Yet, the progressivity of the income tax is the issue of tax policy that you see most often discussed on television. Of course, the wealthy as a class are indeed most concerned about the progressivity of income taxation because that is the tax which they predominantly pay. Yet, that hyper focus on income taxation is
an illustration of a type of trick or, in some cases, may represent even a bona
dide mistake, such as where the television tax commentator may fail to realize
that employment or property taxes, as examples, are onerous to persons that
do not have high incomes by which to pay these sorts of taxes. In any case,
the Social Security Trust Fund cash so accumulated by the toil and sweat of
generations of past workers has now been depleted, which will lead eventually
to a governmental cash flow crisis as current workers cannot realistically be
expected to pay any more in taxes than they already do.

Partly as a result of tax policies designed not to tax capital very much, the
fortunes of the wealthy today are so vast that it requires a stretching of the
imagination to see how any one person could efficiently allocate so much capital
into productive investments. The allocation of large amounts of capital—say,
a billion dollars—into productive investments is a very difficult task, so difficult
that many wealthy individuals do not even attempt to allocate capital efficiently.
Rather, the wealthy often channel largely untaxed capital into huge mansions
or palaces, yachts, private aircraft and so on. Jeff Bezos was recently reported
to have built a mansion with 25 bathrooms, as a prime example.\(^1\) These sort
of expenditures are not productive investments and are designed merely to
maximize creature comforts; they do not generate any economic return to
society besides the initial act of production, and this enhancement of comfort
means very little in economic terms. Contrary to what you may have been led
to believe, it is not economically “efficient” for society to simply produce and
consume comfort items that do not yield any economic return.

If taxes on workers and small business were reduced to more manageable
levels, some workers would be clever enough to allocate small amounts of capi-
tal into productive activities like farms, restaurants or other small businesses that
would generate an ongoing economic return and make society better off. I used
to think that the diffusion of small amounts of capital among lots of Americans
was a key aspect of the American dream and that capital diffusion helped to
explain why the United States was such a successful and prosperous nation. The
politicians who have designed the tax system, though, clearly don’t share these
ideas about capital diffusion and economic policy. Tax policy more and more is
meant to force workers to pay most of the taxes in order to concentrate capital
into a few hands and thereby facilitate the accumulation of vast fortunes by the
wealthy. As they have always done throughout history, the modern-day wealthy
then continue to deploy the capital into building pleasure palaces of various
sorts that do not yield any economic return.

Tax proposals to reduce taxes for workers and small businesses, such as
that developed later in this book, represent the opposite of current economic
and moral theorizing on tax policy. Quite amazingly, however, nearly all the empirical evidence available on tax policy supports a reduction of taxes on work as a means of increasing economic growth. As will be explained further, it is fair to call this the scientific view on tax policy, as it is based on the available evidence. Economic theory is generally not based on evidence. It may surprise you that there is little or no data or other empirical evidence to support the various tax policies proposed by so-called economic experts who call for tax cuts for the wealthy and large corporations. But there isn’t. The deeper you dig into tax policy, the less substance you will find. The object of tax scholarship really is to keep the shovel out of your hands, and thus, to keep you quietly paying taxes through the direct withholding of funds out of your paycheck.

Meanwhile the wealthy and large corporations vociferously complain about taxes but pay almost nothing in relative terms. The corporate share of the tax base prior to the Tax Cuts and Jobs Act of 2017 was 9 percent but was trending sharply downward even before the tax cuts, and may now be as little as 1 percent or 2 percent. The downward trend in corporate taxes was due in part to the lack of enforcement of the corporate tax laws by the government. For example, the Internal Revenue Service has adopted a variety of programs designed not to comprehensively audit large corporations as they do other smaller business and individual taxpayers. With further sharp reductions to the corporate statutory tax rate, the corporate share of the tax base has likely been reduced from 9 percent to much less. For comparison, the corporate share of the tax base ranged between 20 percent and 30 percent in prior decades. As the corporate share of the tax base is further reduced, workers will be expected to pay more taxes into the system to make up the difference, either now or in the future; the timing of when that happens depends, of course, on how quickly the federal system becomes insolvent.

The foremost object of tax policy is accordingly to convince working taxpayers that the tax system is smart, fair and efficient when it is obviously not. The goal of this book is to reveal many of the deceptions that currently exist within tax policy. The deceptions you will read about in these pages are not so different from magic tricks. However, in this case, instead of believing a rabbit came out of a hat, taxpayers are fooled into believing that the tax system is either fair or efficient—it is in reality neither, nor is it intended to be so. The many philosophers who wish to debate the relative fairness of the tax system have missed the important point, which is that only the powerful are interested in debating whether the current tax system may be considered “fair.” The working classes do not find this supposedly philosophical inquiry as to the “fairness” of wage and other types of taxation to be even a valid question and
go about their lives under the assumption that the tax system is grossly and abjectly unfair. And, as will be explained, it turns out it is the workers and not the philosophers who are correct that relative fairness has little practical import or relevance to the design of tax policy.

Professional philosophers have largely failed to recognize that a method of accounting, consistently applied, is strictly necessary to reach moral conclusions about the fairness of the tax system. Insofar as many workers are only aware of a cash-basis means of accounting for tax payments, they have, by necessity, consistently applied that accounting method and reached the cogent conclusion that the tax system is not “fair” to them since workers plainly remit most of the taxes measured on a cash basis. Of course, various philosophers have encouraged the wealthy to believe that the tax system should be considered “fair” by creating special accounting methods to be creatively applied on a noncash basis within their own moral frameworks. These special accounting methods make it possible to say that the wealthy should be assumed to have paid a proportionate share of taxes to then allow for a supposed “redistribution” for basic needs in the “welfare state,” as example. In any case, the results are thereby twisted to such a degree that some background in accrual accounting (or even forensic accounting) is helpful in attempting to apply the many special accounting methods of moral philosophy to tax policy. This will be explained further below.

The broader purposes of the overall tax system are better revealed by what is referred to as “postmodern” philosophy and are actually twofold: The first purpose is to collect tax nearly exclusively from workers by withholding directly out of their paychecks. The second purpose is to allow the wealthy to feel powerful by not paying much of anything in tax. This is often achieved as a result of what the wealthy consider “prudent” tax avoidance planning—yet, such means of rational tax avoidance are only made available to relatively wealthy persons under the tax laws. Both of these elements are absolutely necessary to the functioning and design of the current tax system. The American billionaire Leona Helmsley stated it best: “We don’t pay taxes. Only the ‘little people’ pay taxes.” That is basically an accurate factual description of the tax system. Helmsley was a real estate heir and for long the richest person in the United States. Similar to Bezos’s 25 bathrooms, Helmsley famously left $11 million in a trust fund for her dog upon her death. She captured in these few words the postmodern view of taxation and tax policy: The wealthy don’t pay much tax relative to either their income or accumulated wealth and that the reason for this is that the wealthy are simply more powerful than the working class. The wealthy further view workers as “little people” and that is how the
wealthy classes justify to themselves not paying much tax even though this is both economically inefficient and morally wrong.

**THE CLASSIC DECEPTIONS**

Now let us proceed to the analysis of the classic deceptions that are used to create tax policy. Please note that not a single one of the claims in this list is accurate or true:

- Deception #1. Tax cuts for the wealthy will cause economic growth.
- Deception #2. Large corporations are experiencing a cash shortfall that can be alleviated by cutting their taxes.
- Deception #3. Capital is like a delicate hummingbird: It is mobile and will leave if subjected to tax.
- Deception #4. By inventing a special way to count taxes, we conclude the wealthy pay significant amounts of tax (e.g., the top 1 percent pay roughly half of all taxes).
- Deception #5. Statutory tax rates, not effective tax rates, are what’s important to tax policy.
- Deception #6. High business tax rates reduce economic growth by reducing the economic return on investment.
- Deception #7. The working poor don’t pay taxes because income tax rates are progressive.
- Deception #8. There are no social costs to high taxes on workers.
- Deception #9. Workers and poor people are cognitively inferior to the wealthy and unable to make rational economic decisions.
- Deception #10. Tax cuts for large corporations are the only viable tax policy option and never tax cuts for small business.
- Deception #11. Tax cuts for large corporations will reduce prices on consumer products.

The following sections lay out why every one of these statements is a deception, a trick played on taxpayers to ensure that the wealthy and corporations don’t pay anything close to a proportionate share of the tax base.

*Deception #1. Tax cuts for the wealthy will cause economic growth*

Tax cuts for the wealthy will actually not lead to economic growth. This idea is not novel as it has indeed been tried before, time and time again, throughout
human history. In reality, there is no empirical evidence that tax reductions for the wealthy cause economic growth or that lower tax rates for the wealthy foster economic growth. The bulk of the evidence suggests that the opposite is probably true.\textsuperscript{5} Nearly all the empirical evidence on record indicates that higher levels of per capita gross domestic product (GDP) are associated with higher taxes. This is true both for cross-country comparisons and also over time within individual countries where the taxes have changed.\textsuperscript{6} A few very small countries have established themselves as tax havens, including, for example, Ireland and Singapore, and these small countries are the exception in international tax policy and cannot be used as a guide to setting tax policy in larger countries; in essence, these tax havens have positioned themselves as parasites of other countries. In all other contexts, the empirical evidence indicates that higher taxes are associated with higher GDP in every country and in every historical period on record. So far, economists have not produced a sliver of evidence—not even a correlation between these variables of tax cuts and economic growth. The empirical evidence is so obviously to the contrary that it is rather silly to search for such a correlation where none exists. However, there are examples of tax increases on capital appearing to have directly caused spurts of economic growth, including in the implementation of the Tax Reform Act of 1986.\textsuperscript{7}

A novel idea that has never really been tried before, except in Switzerland, which taxes wages relatively lightly,\textsuperscript{8} is not taxing workers at high rates and seeing if that sort of progressive tax policy causes economic growth. I wish to propose that it is plainly obvious based on the available evidence that a tax cut for workers and small businesses would cause sustained economic growth. Ironically, such tax cuts for workers is the very tax policy that economists nearly unanimously counsel against. The wealthy have been able to escape taxes throughout history, and nothing about minimizing taxes for the wealthy and hoping for economic growth is a new policy idea. Exempting the wealthy from paying taxes has been done time and again and it seems to result in the building of lots and lots of fancy palaces and the acquisition of more and more creature comforts but not economic growth.\textsuperscript{9}

\textit{Deception #2. Large corporations are experiencing a cash shortfall that can be alleviated by cutting their taxes}

Although tax scholars and television and radio commentators constantly repeat the claim that corporate tax cuts cause economic growth, this simply makes no sense. Large corporations have been experiencing a cash surplus, not a cash shortfall.\textsuperscript{10} In fact, large corporations have accumulated so much cash on their
balance sheets that it threatens the stability of the economic system. The total amount of cash held on corporate balance sheets exceeded $3 trillion at the time of the drafting of this book. Additional tax incentives to these firms should not be expected to cause economic growth—they should be expected to increase corporations’ hoarding of cash to ever-larger amounts. Many large firms operate their businesses as an annuity, with the goal of drawing out as much cash as possible from the business without reinvesting capital.

If someday there does appear some empirical evidence that corporate tax cuts do cause economic growth, this would be attributable not to the availability of cash, but to how the tax cuts might enhance the optimism of corporate executives to make capital reinvestment. But, lots of economic policies apart from tax cuts could have a positive or negative impact on the optimism of corporate executives. Because nearly all economic activity is linked to consumer spending, tax cuts for consumers would seem more likely to increase consumer spending and to thereby increase the prospects of economic growth as business spending might then increase to match the increase in consumer spending. The contrary economic idea that higher consumer spending might arise from corporate tax cuts to companies with ample surpluses of cash seems utterly unrealistic for many reasons. Large corporations have ready access to credit and even if they were short of cash could easily borrow money to fund incremental business investment. If large corporations are not making capital investments into the broader economy it really does not seem plausible to conclude this is a result of the lack of capital that must be alleviated through the tax system—the underlying idea just isn’t plausible.

Deception #3. Capital is like a delicate hummingbird: It is mobile and will leave if subjected to tax

Many large corporations operate by harvesting profits by and through a dominant market position, where the business is operated like an annuity and the maximum amount of cash is drawn out from the operating business with the minimum amount of capital reinvestment. Such profit harvesting is best accomplished when the competition has been eliminated from the local market somehow. In economic terms, this market advantage is known as collecting economic “rents” out of the marketplace, and firms that engage in this are described as rent-seeking market behavior. One way to use tax policy to facilitate rent-seeking market behavior by large businesses is through granting preferential tax treatment to only large corporations. The benefits that the current tax system delivers to large corporations comes at the expense of small businesses
in the marketplace by reducing the relative rate of economic return to these competitors. At one point, small businesses were competitors in the marketplace in various lines of business, but now are unable to make a profit after taking into account the relatively higher tax rates charged to small business in comparison to large business. Once the small businesses are out of the picture, the large corporations are positioned to provide a good or service in the absence of any competition and can charge whatever price they determine that consumers might be willing and able to pay.

The term “rents” is helpful here because corporate activity can be thought of like a landlord who wishes to collect rents from tenants. A good example is a Walmart superstore that serves a locality and has no competing local stores. Just like landlords are unlikely to stop being landlords if there is still some rent to be collected—that is, profit to be made, without regard to the tax rate—corporations are the same. This Walmart will leave the locality only when its market position has been eroded in some way and that erosion has reduced available profits (or “rents”) to zero. This might occur if the Walmart is subjected to competition from another large grocery or retail chain, like Target or Kroger. Tax policy could have a negative impact on Walmart if, say, Target stores were exempted from various types of tax but Walmart stores were not. Such an unequal tax treatment would potentially erode the market position of one business at the expense of another. However, this rarely, if ever, happens to large corporations. In contrast, it is nearly always the case that small businesses are subjected to much higher tax rates than large corporations, so the tax system accrues to the benefit of large corporations and at the expense of small business. This makes it unlikely that corporate taxes have any effect on large corporations at all, and they certainly would not cause them to raise prices. Redesigning the tax system to foster competition in the marketplace might even lead to lower prices by increasing competition to large corporations in the marketplace and forcing them to compete with small businesses on price.

Large firms, especially after the Tax Cuts and Jobs Act of 2017, are generally taxed much less than small businesses; this rate differential reduces the after-tax rate of return to small business and ultimately assists large corporations in eliminating small businesses as competitors in the marketplace. Large firms may thus continue to enjoy monopolistic market conditions across the United States and increasingly in Europe and can extract rents from the marketplace to an extraordinary degree. An example is Starbucks, which now operates in many European cities with very low effective tax rates even though many local coffee shops in those same cities are subject to taxation on any profits at hefty European tax rates. Accordingly, it is rather outrageous to suggest that large
corporations such as Starbucks might fly away like a delicate hummingbird from these market monopolies because of corporate tax. The hummingbird analogy simply is not as pertinent to large firms as it might be to small ones. Large corporations are more like crocodiles than hummingbirds. Once they move into a body of water, they will stick around until they have completely exhausted all the food sources—that is, profits or rents. Not even levying a tax will make that crocodile move to a new river if there remains even one wildebeest or small coffee shop owner waiting to be consumed.

Deception #4. By inventing a special way to count taxes, we conclude the wealthy pay significant amounts of tax (e.g., the top 1 percent pay roughly half of all income taxes)

Several tax organizations operate tax policy websites that continuously publish reports that the rich pay lots of taxes. Often the claim is that the top 1 percent pay half of all US income taxes. Another oft-quoted statistic is that 50 percent of the population pays 97 percent of the income taxes. The implication is that because of the progressive tax rate structure of the federal income tax system that workers and lower-income workers do not pay as much in taxes as the wealthy. These organizations do not attempt to determine the source of federal tax receipts apart from current year income taxation that comprise the federal budget, however. Wage taxes, which are levied pursuant to a regressive rate structure (where a ceiling is applied and earnings above the ceiling are exempted from wage tax) are simply ignored by dropping the word wage before taxes and slipping in the word income as if that were a reasonable assumption in the formulation of tax policy. However, it’s not a reasonable assumption. These tax policy organizations claim to be bipartisan—and that’s true to some extent—as perhaps the only thing Republicans and Democrats agree on is that workers should fund as much of the tax base as possible. So, these organizations create misleading statistics that support the idea that the wealthy are remitting a disproportionate amount of the tax base through progressive federal income taxation, which just isn’t true.

The reality of the federal budget is quite different from what you’ve been told by these tax policy organizations. The truth is this: A large portion of receipts arise from wage withholding in the form of Social Security and other taxes levied on workers, not from income taxes levied on the wealthy. The tax organizations that publish the misleading statistics are aware of this reality, so they need to create an explanation as to why only income taxes should count as federal tax receipts, rather than wage tax receipts, or federal government...