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TAXLETTER

Should We Continue "Bush Tax Cuts"

Please accept our apology for skipping the June 2012 taxletter

The well known "Bush Tax Cuts" (BTC for short) were tax changes enacted first in 2001 and 2003. All of the BTC provisions were set to expire on December 31, 2010. However, most of them were extended for 2 years until December 31, 2012.

Now, we are in a Presidential election year and all things political. Further, we have a diverse Congress and a President who blame everything "Bush". What happened to another extension of BTC or a selective extension of BTC, your guesses are as good as mine. Instead of guessing the political outcome, we would rather spend our time looking into certain key impacts on the majority of the taxpayers.

Tax Rate and Tax Bracket

Currently, a low-to-middle income family, married filing jointly, their tax rates and brackets are 10% up to $17,400 taxable income, and 15% up to $70,700 taxable income. If this family taxable income is $50,000, their total Federal income tax will be $6,630. (Note: taxable income is income subject to income tax after all deduction and exemptions)

Before BTC, there were no 10% bracket, the starting point was 15%. Thus, the same family with the same taxable income, their before BTC total Federal income tax would be $7,500. They have to pay 13% more Federal income tax.

For a middle income family with a taxable income of $140,000, currently their total BTC Federal income tax is $27,060. However, their before BTC total federal income tax would be $30,009. They have to pay 10.9% more Federal income tax.

For the very high income and super rich taxpayers, their impact will primarily be affected by the highest maximum individual tax rate. Currently, the maximum rate is 35%. The before BTC maximum rate was 39.6%. The real impact for this group of taxpayers will be from 35% increased to 39.6%, a mere 4.6% increase.

Based on the above analysis, our readers can easily realized that proportionally Bush Tax Cuts gave lower income taxpayers greater savings. From savings at 13% to 10.9% for the lower and middle income taxpayers, but only 4.6% savings to the very high income and super rich group of people.

Looking from this angle, the Bush Tax Cuts are fair because it offers a balanced picture, " higher your taxable income will be, lesser your saving will be ".

Dividend and Long Term Capital Gain

Under the BTC provisions, the qualified dividend tax rate will be same as long term capital gain (LTCG for short) rate. Both of these tax rates were set at a maximum 15% regardless of the income level of the taxpayer. As such, they are much lower than the tax rates for all other types of income. Before BTC, dividend was taxed at the same rate as interest income which could be at high as 39.6%, and the pre-BTC maximum tax rates for LTCG was 20% and 25% for un-recaptured gain.

First, a large number of our population believed in a myth that “dividend” and “LTCG” are reserved for the high earners and rich people. <u>This is not true</u>. According to the statistics published by the IRS, the proportional difference between all tax returns with “Adjusted Gross Income (AGI)” above and below $250,000 was zero for practical purposes. This means that the amount of “dividend plus LTCG” income reported by taxpayers having AGI below $250,000 as a percentage to their AGI were similar to those reported by taxpayers having AGI above $250,000.

Second, for great many retired elders their livelihood after retirement need a sufficient return from their life-time savings to supplement their retirement income. How and where their life-time savings are invested is **<u>extremely</u>** important. Therefore, an investment in long term secured deposits and/or bonds would be a very low-risk alternative. For the past 4 years, because of the economy, the Federal Reserve artificially suppressed the rate of interest which retired elders relied upon. Yes, the income tax rate for interest earning could be high. However, if the rate of interest were allowed to be set freely by market forces, the overall interest earned by the elders would be correspondingly much higher. Thus, the after tax amount could be sufficient to supplement their retirement living.

Since the retired elders can no longer rely on interest earned from safe and sound deposits/bonds, they needed to find other alternative low-risk investments. Therefore, stocks from Corporations having a long stable history and paying reasonable amount of dividend are the targets of their current investment strategies. Under BTC both the dividend and LTCG are taxed at a maximum rate of 15%. As an alternative to near zero interest from reliable deposits/bonds, the retired elders can once again rely on something safe and sound to obtain their needed after tax returns to support their retirement living. If the dividend and LTCG tax rates are allowed to return to pre-BTC era, great many retired elders will be once again thrown into danger that they may not be able to sustain their retirement livelihood. Any such thinking and/or proposal are heartless and evil.

Sincerely,

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