PART I

WELCOME TO THE WAR ON WEALTH

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CHAPTER 1

The Weapons of Mass Destruction in the War on Wealth

Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.

—Ronald Reagan

Taxes are the weapons of choice used by the government in its War on Wealth. Income tax, dividend tax, capital gains tax, estate tax, and income tax again on retirement plans are the new WMD. They may not be Weapons of Mass Destruction, but they are Weapons of Mass re-Distribution. Further, it impacts a hell of a lot more than 5 percent of U.S. taxpayers. *You are the target.*

This chapter poses a simple question, "Just how many times can you tax the same damn dollar?" I tell you in advance that you're not going to like the answer, but you need to know what you're up against. We work under the brunt of a tax system that can impose different types of tax on the same dollar up to *three or four separate*

times. With every tax dollar you pay you move farther along the road to accidental philanthropy. Let's take a look at each tax, when it is applied, and just who pays it. If you have any antidepressants or antacids lying around the house, you may want to take them *all* now. Put the laxatives away—you're not going to need 'em.

Tax #1: The Federal Income Tax—Negative Impact 28 Percent to 35 Percent. Going to 36 Percent to 40 Percent

Before I get into what the income tax rate is now and what it will be when the Bush tax cuts expire in 2011 (as proposed under President Obama's budget), let's take a look at who *actually pays this tax* and how much we pay.

Table 1.1 shows that, according to the latest IRS statistics (based on 2006 Adjusted Gross Income, AGI), the top 5 percent of the highest earning Americans, pay more than 60 percent of all the income taxes paid. But here is the stunning part of that statistic—to be in that category you only need income over $153,000! To be in the top 10 percent, who pay 71 percent of all the taxes, your earnings only need to exceed, $108,000. If you want to be in the rare air of the 1 percent who pays 40 percent of all the income taxes, you only need adjusted gross income greater than $389,000. The bottom 50 percent pays less than 3 percent of the tax burden.

The takeaway from Table 1.1 is that while everyone seems focused on the evil top wage earner making more than $250,000 per year, the reality is that if you're earning more than $150,000 you're bearing the brunt of taxes as well. How much are we talking about? Take a look at Table 1.2.

We may not like it, but it is the simplest to understand. For every new dollar we earn, we give away currently 33 cents to 35 cents. When the Bush tax cuts expire at the end of 2010, that number increases to 36 cents to 40 cents. Not great, but if that was the only time that dollar was taxed I don't think many of us would complain. I'm not saying we'd be throwing a party, but we wouldn't be miserable either. The problem is that if you play by the rules and save some of your money instead of spending it all, the government repays you by continually taxing that same dollar. How? Read on.

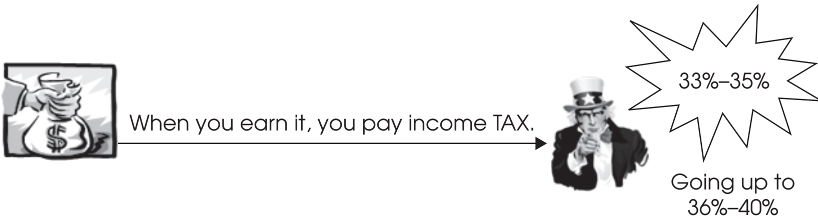
Table 1.1 Income Taxes Paid by Catagory

Percentage Ranked by AGI	AGI Threshold on Percentages	Percentage of Federal Income Tax Paid
Top 1%	$388,806	39.89
Top 5%	$153,542	60.14
Top 10%	$108,904	70.79
Top 25%	$64,702	86.27
Top 50%	$31,987	97.01
Bottom 50%	<$31,987	2.99

Source: IRS Statistics via Kiplinger.com, July 25, 2008, "What's Your Share of the Nation's Tax Bill?" by Kevin McCormally.

Table 1.2 Current and Proposed Income Tax Rates.

2009 Tax Bracket	AGI Range for Married Couples	AGI Range for Singles	Proposed Increase in 2011
28%	$137,050–$208,850	$82,850–$171,550	28%
33%	$208,850–$372,950	$171,550–$372,950	36%
35%	<$372,950	<$372,950	39.6%



Tax #2: Investment Income Tax—Negative Impact: 15 Percent to 35 Percent. Going up to 20 Percent to 40 Percent

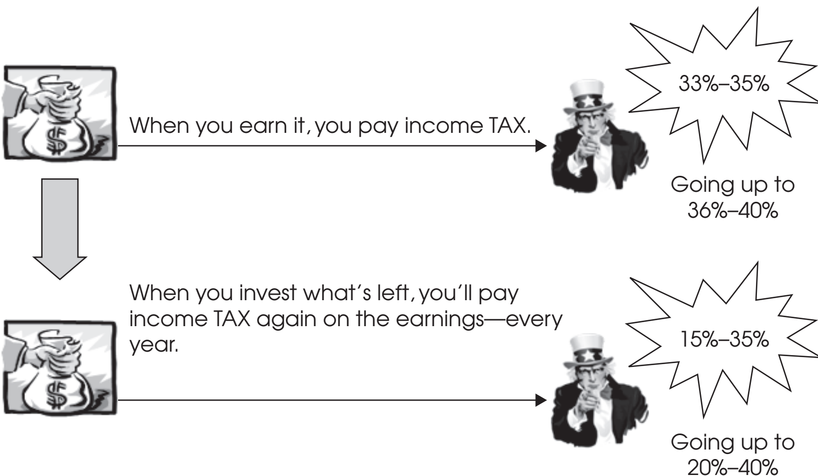
After you have paid income tax on your earnings, you have a choice as to what to do with what's left. You can spend it, you can save it, or you can do a combination. Remember, we're talking about your after-tax earnings, not your 401(k), or other pretax

retirement plan (we cover those later). You probably spend some, save some in an effort to accumulate a nest egg for whatever the future holds. You would think that a country with one of lowest savings rates in world would provide an incentive to save, we don't. In fact, we do the opposite; we tax the crap out it.

If you invest that after-tax dollar into corporate America (you know, the stuff capitalists do to make money and help the country grow) you'll pay a tax on your earnings. If you buy corporate bonds the annual bond income is taxed at your ordinary income tax rate. If you buy a stock that pays a dividend, you'll pay tax at the current dividend tax rate of 15 percent. Both rates are scheduled to increase under the proposed budget.

If you choose to invest some of your savings into other programs like real estate or more exotic funds, you will not escape an additional tax on your investment earnings. Municipal bonds are the only income-producing investment that is tax-free. Have you looked at those returns lately?

There's no need to beat this to death, I have far more disturbing stuff to get to. I just want you to be aware of tax #2. A lot of people skip over it like it's not a big deal. It is.



Tax #3: Capital Gains Tax—Negative Impact: 15 Percent Going to 20 Percent

In my view there is nothing quite as harmful as the tax on capital gains. It is a pure penalty imposed on the capitalist for investing in something that works. For the U.S. business owner, it is the ultimate slap in the face for his or her success. It is like the government saying, "Our way of thanking you for building this country is to tax you on the profits you made on the money we've already taxed, after taxing you on all the income that you produced." Does that make any sense to you, or is it just me?

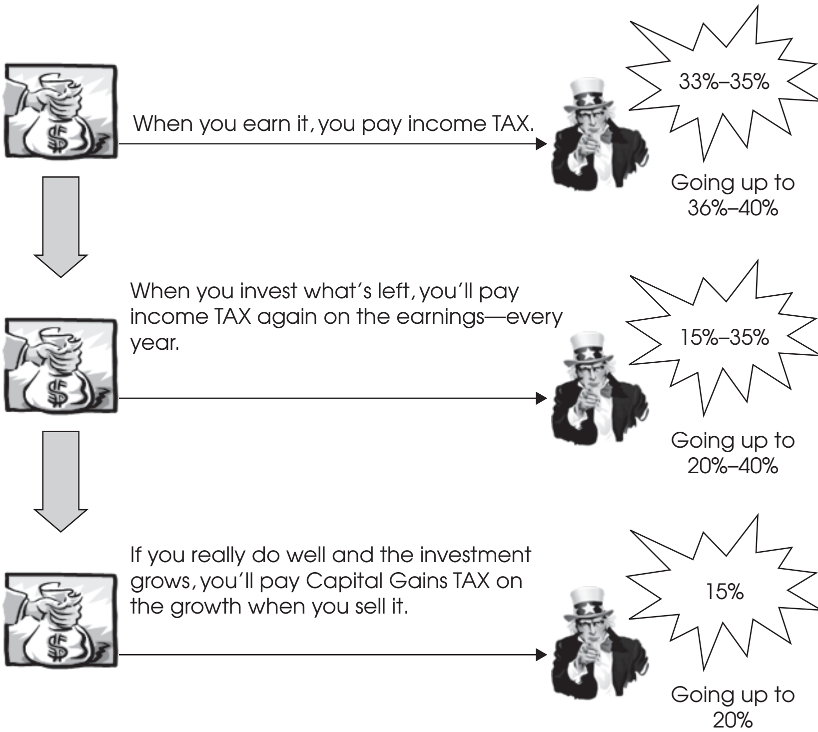
Like the federal income tax, the sweet spot for capital gains tax is the top 5 percent of income earners. People earning more than $154,000 per year account for 89 percent of all the capital gains tax paid! That is a stunning number. Even more stunning is the fact that the tax rate, currently 15 percent will increase under the proposed budget to 20 percent in 2011. That ought to stimulate the economy, right? Table 1.3 shows the stats on who pays the capital gains tax. For example, if you are a taxpayer in the top 10 percent of wage earners, your group accounts for more than 94 percent of all the capital gains taxes.

So, if you're keeping score, first you pay 40 percent tax on the income you earn. Then, you take some of that remaining income and invest it for the future, and you pay 20 percent to 40 percent on the income that it generates each year. Then, if you're lucky enough to invest in something that appreciates in value over time, you pay tax again when you sell it; to the tune of another 20 percent! And, that's just the injury; we haven't gotten to the insults yet.

Table 1.3 Who Pays Capital Gains Tax?

Percentage Ranked by AGI	AGI Range in Dollars	Percentage of Capital Gains Tax Paid in Range
Top 1%	>$396,000	72.6%
Top 5%	$154,000–$396,000	16.9%
Top 10%	$110,000–$154,000	4.8%
Top 20%	$77,000–$110,000	3.2%
Bottom 80%	<$77,000	2.5%

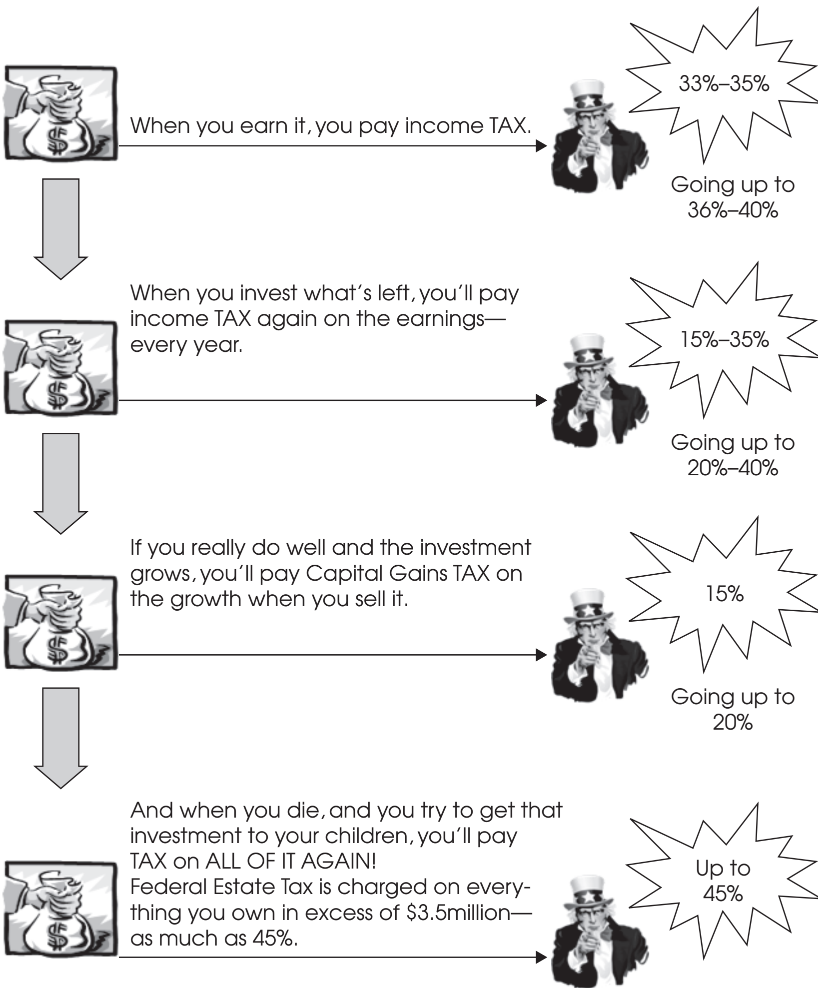
Source: IRS Statistics of Income, 2006; Institute on Taxation and Economic Policy, March 2006.



Tax #4: Federal Estate Tax—Negative Impact: 45 Percent on Transfers at Death Over $3,500,000

And then, you die. Imagine that after paying tax all along the way during your life, you get one more parting shot when you die and try to transfer what's left to your kids. The message behind this tax is very clear; it is redistribution of the wealth in its purest form. It is the government standing between you and your children. It is that simple.

Federal estate tax impacts less than 2 percent of Americans each year, but accounts for more than $22 billion in tax revenue. We all receive a tax credit on the transfer up to $3,500,000 at death. Estate tax kicks in after that to the tune of 45 percent. Here's the part you need to understand. Unlike the other three taxes you pay along the way, the federal estate tax is not a tax on new income or new growth. It is not a tax related to cash flow at all. *It is a tax on all your stuff*!



And don't think you can do something clever like give it to your kids before you die, because you'll pay Federal GIFT TAX on all gifts in excess of $1, million at the same 45% rate! And gifts to grandchildren in excess of $3.5 million get hit with an additional 46% tax on top of the Gift TAX.
Yes, it is possible to pay more tax than you actually gifted!

Everything, your house, your car, your rugs, your collectibles, your jewelry, your investments, your *retirement plan* (I get into more detail on that in a minute), your business, your investment real estate, your insurance, your furniture, everything you own is subject to estate tax. Even stuff you inherited from other family members—that you already paid tax on—is subject to tax.

And here's the cruelest rub of all, though your assets are valued at current market prices, even if they are illiquid, the government wants cash—in nine months. Can you imagine forcing a sale of a home in the current real estate market? Do you think you'd get what the home is worth, especially if the buyers knew there was a government clock ticking?

Estate taxes can be devastating because it sucks out all of the cash first, and leaves the family with illiquid assets. The net result to the family can be far worse than the 45 percent price tag.

Don't think that you can fool the IRS by gifting your assets to your children before you die. You can't beat 'em, in fact the tax could be worse. The gift tax rates are the same as the estate tax rates with one major difference, the free pass ($3,500,000 at death) is only $1,000,000 for gifts. Skip the kids and go directly to the grandkids and you face an *additional* generation-skipping transfer tax of 46 percent on transfers more than $3,500,000.

But Wait, There's One More Tax

Do you have any idea what happens to your IRA when you die? You better grab a bucket; you're going to need it.

The war on wealth takes place on many fronts; the bloodiest of these is the battle over control of the destiny of your retirement plan. Retirement plans come in many types: IRA, 401(k), SEP, SIMPLE, TSA, or 403(b). They are lumped together as "qualified retirement plans." To keep things simple I refer to all qualified plans as IRAs. They are savings vehicles that the government allows you to fund on a before-tax basis. Of course, the amount you can deposit each year is capped because we wouldn't want to encourage you to save too much. Your deposits are invested, and the whole thing grows without tax until you begin to draw on it in retirement. The theory is that when you reach retirement age you're in a lower tax bracket. How's that been working out for you?

But what happens when you die? Where does the remaining balance of your IRA or other qualified plan account go? If you're like most people, you designate your spouse as the beneficiary. That works, until she or he dies. Then it becomes a tax orgasm for Uncle Sam, and that is not a pretty sight for the following reasons:

- The entire value of your IRA is included in your estate for federal estate tax purposes. Although the value IRA itself may not exceed the $3,500,000 threshold, it is added to other assets, pushing up the value of your taxable estate. The amount that the IRA exceeds the unified credit is subject to federal estate tax.
- With or without the federal estate tax, the full value of the IRA must be declared as ordinary income because it is distributed to the next generation. This special income tax, imposed on *Income in Respect of a Decedent* (IRD), will place the IRA squarely in the highest income tax bracket.
- Finally, if you intend to skip your kids and give your IRA directly to your grandkids, the generation-skipping transfer tax (46 percent) is added to the estate and income taxes.

So, what I'm saying is that the least amount of tax you'll pay on your IRA distribution is 35 percent to 40 percent, and, if your estate is large enough, you could pay 63 percent to 70 percent! In Table 1.4 I show what happens to a $1,000,000 IRA in three different taxable estates.

Let's start with the easy stuff. If your IRA is worth $1,000,000 in an estate that is less than $3.5 million total, the tax is $350,000 (35 percent) and that becomes 40 percent or $400,000 in 2011. When is the last time you wrote a tax check that large? And, that's as good as it gets!

When we factor in the estate tax, let's just say the result is not very pretty. If the estate size grows to $4 million, of which $1,000,000 is IRA assets, you pay income tax plus estate tax. The estate tax is $225,000 and the income tax on the balance of the IRA that is not used to pay the estate tax is $271,250. The combined

Table 1.4 $1,000,000 IRA

IRA Value	Taxable Estate	Estate Tax	Income Tax	Total Lost to Tax	Net to Family	Percentage Lost
$1,000,000	Under $3,500,000	$0	$350,000	$350,000	$650,000	35%
$1,000,000	$4,000,000	$225,000	$271,250	$496,250	$503,750	50%
$1,000,000	$5,000,000	$450,000	$192,250	$642,500	$357,750	64%

Source: "Capital Punishment by Confiscation" software, Number Cruncher, Stephen R. Leimberg and Robert T. LaClair, March 2009.

taxes are $496,250 and the family receives $503,750. Your tax on the IRA just became 50 percent!

If the estate crosses the $5 million level, with a $1,000,000 IRA, you now enter the *64 percent* tax rate! The estate tax is $450,000 and the income tax adds another $192,500 for a total liability of $642,500. Your kids now only receive $357,500. Look at this: *the government actually gets more from your IRA than your kids do*! Imagine building a retirement account just for congress to play with.

Don't shoot the messenger.

How Many Times Can You Tax the Same Damn Dollar?

The same dollar is subject to tax three or possibly four times. The increases in income tax rates, dividend tax rates, and capital gains tax rates as proposed in the 2009 budget stand as road blocks on the road to wealth accumulation. However, the attack on capitalism reaches its pinnacle when you die; when all the past taxes are coupled with the insane taxation on retirement plans and estates at death. Talk about an Axis of Evil! Table 1.5 illustrates my point.

The table shows you four different asset value views of a poor shmoe who bought into the same American dream as the rest of us (the one where you work hard, depend on yourself, build your fortune, pass it on to your kids) only to have the rug pulled out from underneath him by his elected representatives who never worked a single day of their lives in the business world. Our man, we'll call him Mr. Schmooley, is a married business owner somewhere in his mid-sixties. He has spent his life building his business from nothing; hence, after deprecation, there is zero cost basis. He has a home, maybe a vacation property and some investments. His wife, the lovely Mrs. Schmooley, has had a long career in public education. Most of her savings has taken place in her Tax Sheltered Annuity (also known as a 403[b] or TSA). When coupled with Mr. Schmooley's retirement plan, they have about $1,500,000 of qualified retirement accounts. Lucky Mr. S. is about to sell his business and enjoy a life of leisure. It all sounded so good, he didn't know he was about to get nuked by the WMD in the war on wealth. His last words were, "funny, I didn't know I was wealthy . . ."

Table 1.5 The Four Faces of Mr. Schmooley

	Case #1 Bus.: $5,000,000 ($0 basis) Inv./RE: $3,000,000 IRA: $1,500,000 Estate: $9,500,000	Case #2 Bus.: $5,000,000 ($0 basis) Inv./RE: $2,000,000 IRA: $1,500,000 Estate: $8,500,000	Case #3 Bus.: $5,000,000 ($0 basis) Inv./RE: $1,000,000 IRA: $1,500,000 Estate: $7,500,000	Case #4 Bus.: $3,000,000 ($0 basis) Inv./RE: $1,000,000 IRA: $1,500,000 Estate: $9,500,000
(1) Capital Gains Tax Loss at Sale of Business	$1,000,000	$1,000,000	$1,000,000	$600,000
(2) Net Estate at 1st Spouse's Death	$8,500,000	$7,500,000	$6,500,000	$4,900,000
(3) Free Pass Via Unified Credit	$3,500,000	$3,500,000	$3,500,000	$3,500,000
(4) Net Estate at 2nd Spouse's Death (row 2 - row 3 = row 4)	$5,000,000	$4,000,000	$3,000,000	$1,400,000
(5) Net Estate Tax	$675,000	$225,000	$0	$0
(6) IRD (Income) Tax on IRA at Death	$330,000	$510,000	$600,000	$600,000
(7) Total Estate Tax (5 + 6 = 7)	$1,005,000	$735,000	$600,000	$600,000
(8) Total of All Tax (7 + 1 = 8)	$2,005,000	$1,735,000	$1,600,000	$1,200,000
(9) Net to Family (gross estate – 8 = 9)	$7,495,000	$6,675,000	$5,906,000	$4,300,000
(10) % of Total Lost Without Control	21%	21%	21%	22%
(11) % of IRA Lost Without Control	67%	51%	40%	40%

Case #1 shows Schmools at his most successful:

- Business value at $5,000,000 (all subject to capital gains)
- Investments and real estate valued at $3,000,000
- Combined IRAs at $1,500,000
- Total gross estate of $9,500,000

Case #2 shows the Schmoolster, still very successful, but not as fortunate in the investment world:

- Business value at $5,000,000
- Investments and real estate valued at *$2,000,000*
- Combined IRAs at $1,500,000
- Total gross estate of $8,500,000

Case #3 shows our hero with his brains beaten in by the stock market:

- Business value at $5,000,000
- Investments and real estate valued at $*1,000,000*
- Combined IRAs at $1,500,000
- Total gross estate of $7,500,000

Case #4 shows the Schmoolinator after a business downturn and market upchuck:

- Business value at *$3,000,000* (still, all subject to capital gains)
- Investments and real estate valued at $1,000,000
- Combined IRAs at $1,500,000
- Total gross estate of $6,500,000

Some Assumptions

Note, Table 1.5 assumes the President Obama tax increases (based on the 2009 proposed budget) are in effect (i.e., the top income rates increase to 40 percent and 36 percent—I know it's 39.4 percent, I'm rounding; capital gains tax rates increase to 20 percent; federal estate tax exemption held at $3,500,000 per person, excess taxed at 45 percent). Both Mr. and Mrs. S. take advantage of the combined unified estate tax credits totaling $7,000,000.

The first thing that smacks you in the face in the table is row 1, the tax loss resulting from the sale of the business. The folks who want to redistribute your wealth ask, "What are you complaining about, you got to keep $4,000,000?" The appropriate response is, "What the hell did *you* do for your $1,000,000?" I said appropriate response—not your first response—I don't use that kind of language. In Case #4, the lost dollar amount is reduced to $600,000

because the sale price has been reduced to $3,000,000. It's still 20 percent, and it still stinks, but the impact is greater since we're dealing with a smaller pot.

The rest of calculations occur at the death of the second spouse, when the estate is transferred to the Schmooley children. After taking into consideration the full use of the unified credit for both spouses, only the first two cases are subject to federal estate tax (row 5). Remember, that's paid in cash—in nine months.

Next, row 6 shows the Income in Respect of a Decedent (IRD) Tax on the IRA money that's supposed to go to the kids. Since they cannot roll it to their own IRAs, the result is a 40 percent tax on *all* of the IRA that has not been used to pay estate taxes. So, even in estates that pay no estate tax, redistribution takes place. What's interesting is that the largest estate (#1) pays about one half the IRD tax of the smallest estate (#4) on the same amount of IRA money.

Rows 7 and 8 show the total amounts of real dollars that are taken away from the Schmooley family and redistributed elsewhere via the tax code. The kids get what remains in row 9. While no one is going to need to hold a telethon to get by, that's really not the point is it? Or is it? Please put yourself in the Schmool's shoes and walk around for a moment. That was his and his wife's money. They worked for it, they earned it. His business generated jobs and income taxes for years. Why shouldn't they keep what they earned? Why shouldn't their kids benefit from it? Where's the incentive to take the risks needed to achieve something worthwhile? Where's the incentive to save?

The percentage of lost wealth without any control (row 10) is a staggering 21 percent across the board, and the impact on the retirement savings is mind-boggling (row 11). So I ask you, do you have appreciated assets like a business or real estate that you'd like to sell some day? Are you building wealth in a qualified retirement plan?

Our country was only 40 years old in 1816 when Thomas Jefferson said, "To take from one, because it is thought his own industry and that of his father's has acquired too much in order to spare to others who have not exercised equal industry and skill, is to violate arbitrarily the first principle of association, the guarantee to everyone the free exercise of his industry and the fruits acquired by it."

One hundred and ninety-two years later, in October 2008, Barack Obama stated in his now infamous confrontation with Joe the Plumber, "It's not that I want to punish your success, I just want to make sure that everybody who is behind you, that they've got a

chance for success, too. My attitude is that if the economy's good for folks from the bottom up, it's gonna be good for everybody . . . *I think when you spread the wealth around, it's good for everybody*."

Welcome to the change you can believe in. What you may not believe, however, is how those crazy cats in congress spend your money. If taxes are the injury, what they do with them is the insult.