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By Max J. Rudolph, FSA CFA CERA MAAA

Tax Code

With deficits dominating the economic landscape, the Presidential race has featured several tax plans that purport to balance the federal budget while also creating jobs. These certainly seem like contradictory goals since collecting more in taxes leaves less available for investing in businesses. Here are some of my ideas to revamp the tax code. The primary goal should be to make the code simpler. Accountants can add value but not if they are all developing strategies for tax minimization. We need to move more professionals into value creation roles and away from being paid to get more of the pie. The pie needs to grow.

We have several options to deal with the federal debt. We can spend less, collect more, inflate the currency so nominal GDP rises relative to debt, or some combination of all of them. It appears that the politicians have chosen the inflation strategy. This will make those who have bought our fixed Treasury bond debt mad as the value of these assets gets decimated. It can also be hard to control. Once inflationary expectations are rampant it is hard to reign them back in. I have told others that if the central bank can manage inflation to 15% and not let it get worse they will have been quite successful. We'll see if that is a reasonable goal. I personally don't think they can do it, and encourage clients to run scenarios that approximate hyperinflation. Keep in mind that this is not a short-term prediction and could take 10 or more years to play out.

Is Mr. Buffett another Carnegie? Andrew Carnegie became guilty as he aged about how he had made his fortune at the expense of others, spending his last years trying to give much of it away, bequeathing a foundation that built libraries across the nation. Is Warren Buffett doing the same with respect to his personal level of taxation? He has been notoriously cheap about certain aspects of his life, and his tax payments have personified this policy. When he ran a series of partnerships he rolled his profits back into them. Then he converted all of the partnerships into ownership in Berkshire Hathaway stock, which he has used as an investment vehicle with no dividends paid. Taxes on capital gains are only paid when you sell shares so this has accumulated tax free over the years. As Chairman and CEO he pays himself a token $100,000. As the largest shareholder, his after tax value increases more by keeping this low than if he was paid a level common to other S&P 500 member companies. Finally, he is in the process of donating shares to the Bill and Melinda Gates Foundation. I've spoken of some risks tied to having such a large foundation in earlier newsletters and won't review that here. This foundation has its heart in the right place even though it seems to increase systemic risk.

Here are some ideas to revamp the tax code. Some address Mr. Buffett's practices, some are obvious, and it should be noted that these likely do not go far enough.

- Tax hedge fund pay entirely as income and none as capital gains
- Limit deductions for charitable donations to $1,000,000 annually
- Eliminate tax deductions for charitable donations given to entities where the donor or their family is involved (Mr. Buffett says that he will not leave his kids an inheritance yet by placing them in key positions within his charities they have access to an annuity for the rest of their lives by way of a job)
- Health care premiums should be deductible for individuals – long term we are headed toward national health care in some form, but at least some of the subsidy we see today would go away with this change
- Mortgage interest deduction should have a cap, tied to inflation, of no more than $1,000,000 annually initially. Then it should gradually reduce, or at least hold steady with no inflation adjustments for many years. If you want a big house you should pay for it without a large subsidy from your fellow taxpayers.
- Companies should receive a deduction for dividends paid to owners, with owners paying tax at their tiered income rate.
- Social Security, Medicare and their associated programs should be brought under the budget to reflect the actual cost (including the present value of future payments).
- A gas tax should be set up to keep gas prices high. We will never make the necessary adjustments unless it costs us more. This tax could be applied to pay down the debt until the debt was small, or replace infrastructure. I would start with a floor of $4/gallon and gradually increase it.
- We need to have a consistent retirement program that does not matter if you are a teacher, government worker, railroad worker, self-employed or corporate employee. All of the federal programs for defined benefit plans should be merged.
- Everyone should use the same defined contribution program for tax preferenced saving.
- Contributions to FICA should not be capped.
- All FICA benefits should be taxed, with the lowest tax rate (below which no one pays taxes) set to the amount someone who started full benefits at 65 (soon to be 67) receives. If all you receive is Social Security benefits then you aren’t taxed.
- Health care should become a personal deduction rather than a corporate tax benefit that ties health insurance to jobs.
- While the AMT has been a disaster, it provides a framework to go forward and move toward a limited deduction version of the flat tax.

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