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Tax rates of the rich and famous

According to a White House report released on September 23, the 400 wealthiest American families paid an income tax rate of only 8.2% for the period from 2010 to 2018. The report suggested that the low rate was attributable to the preferential tax rates for capital gains combined with the zero tax imposed upon appreciated assets that are held until death, which benefit from a basis step-up. No mention was made in the report of the contribution of tax-free municipal bond income by the wealthiest as a means to bring down their income tax obligations.

Still, a tax rate of 8.2% seems rather remarkably low for any taxpayer, let alone billionaires. A look at the fine print of the report yields the real factor, one that is far more important than nominal tax rates. “An important feature of our analysis that is less common in existing estimates of tax rates is that we include untaxed (“unrealized”) capital gains income in our more comprehensive income measure as they accrue.”

Characterizing unrealized capital gains as income would be a radical departure in income accounting, one that might be lost on the ordinary reader. The report justified the approach by reference to the “Haig-Simmons” income definition, which includes changes in wealth plus taxes and consumption. Although Haig-Simmons may be helpful in economic analysis and forecasting, it is questionable as a basis for imposing taxes or for calculating true tax rates.

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