Our View of the "Tax Man Cometh"

March 29, 2021

Is the Federal spigot about to turn from very hot to very cold? The $1.9 trillion stimulus package that Congress recently passed and the opening of the larger states has no equal in modern times. Trillions of dollars have been borrowed and created to insure the continuation of an economic recovery. The latest data are confirming that the economy is about to soar as the combination of fiscal and monetary policy and the demise of the virus will contribute to an acceleration for the balance of 2021.

Not only has the fiscal policy stimulus helped many Americans, but there is still more than $1 trillion from the December bill that has yet to be committed and disbursed. Add in the newly passed stimulus funds for infrastructure modernization and you have the economic pundits questioning who is going to pay the piper? The traditional economic world demands that all this deficit spending be paid off.

To offset this deficit spending concern, the Administration is proposing a major tax rate increase. The increase is focused on the wealthy—income taxes on individuals with incomes over $400,000 and a general increase in tax rates for corporations—effectively eliminating the tax rate cuts of the Trump Administration. Even a "wealth" tax could be part of this package. We have not seen the proposals for this fiscal tightening yet, but the indications are that there will be a massive tax increase on the "rich" defined as those working people who have not "paid their fair share." Our bet is that the tax rate increase will be front and center in the second half of this year.

Politicians must be careful of broad-based tax increases. The reason for this concern is the concept of incidence vs. burden. What does that mean? Let us use an example. A few decades ago, politicians decided that rich people were not "paying their fair share." A so-called "yacht tax" was enacted in 1991 to pay down the federal deficit. The tax covered several luxury goods including private jets, furs, and jewelry, as well as yachts. Unfortunately, the impact of the tax was felt by boat manufacturers who lost thousands of jobs as the rich decided not to purchase boats and the yacht industry was destroyed. The tax was abolished in 1993.

Will the current Administration learn from this mistake? The analysis, or manner, of how the burden of a tax is divided between consumers and producers is called tax incidence. The concept that rules is the idea of incidence versus burden. Politicians who think that they can tax the rich to pay for this increased spending fail to realize that the rich can simply choose not to spend thereby making more people suffer as a result. More importantly, tax rate increases negatively impact economic activity. We will continue to monitor this fiscal tightening situation – especially as the economy continues to grow. In the meantime, let's enjoy the benefits of an improving economy and good news on the coronavirus front.