Another Look at a Very Taxing Situation

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Politicians continue to struggle over the tactics to increase taxes to pay for social welfare programs. If history is a guide, these tax revenues seldom “pay” for everything. Only two times in our 80+ year combined investment careers has the government run a surplus -- meaning that spending is less than revenues derived via taxes. Even though federal tax revenues are up 18% so far this year, the proposed plan is to increase tax rates again! They tell us that these higher tax rates will only apply to the “mega-rich” otherwise known as billionaires, but we know that this demographic hires professionals to avoid these levies and, in the end, the middle-class gets burdened and even sometimes the little guy suffers too.

One argument that has gained some fleeting attraction in the Capitol is the idea that taxing the personal income of the rich is not enough, and that the time has come to tax their wealth -- even though the Constitution does not authorize the federal government to step in and confiscate wealth in the name of a tax increase. One of the novel tax ideas is to collect taxes on unrealized capital gains. Read: UNREALIZED!! Billionaires like Jeff Bezos and Elon Musk would be forced to sell billions of dollars of their company stock—Amazon and Tesla, respectively, only to pay the tax man. As regular readers of our Weekly Missive, what do you think would happen to the stock market?? Clearly not good.

One stealth tax that investors and politicians seem to ignore is what we call the interest rate tax. This is the tax imposed on lenders when the Federal Reserve lowers interest rates to favor borrowers with the idea that a transfer of wealth from savers to borrowers somehow benefits the economy. The best example of this enormous tax on savers is the lowering of interest rates on “safe” fixed income investments such as securities that retirees rely on to maintain the value of their savings. Back in 2007, the yield on a typical guaranteed money market fund was around 5%. The financial crash of 2008-2009 was cushioned by a Fed-led reduction in interest rates as it placed a safety net under the financial system. But after the worst of that crash was over and the economy rebounded, interest rates remained near record lows. The supposed stimulus implied by an easy Fed policy never really materialized as the Obama years experienced a sub-par economic recovery. During those eight years, savers essentially saw the returns on their investments fall by 80% or more as the 5% yield on money market funds fell to near zero—and stayed there.

In other words, via Federal Reserve monetary policy, the federal government imposed an 80% tax on the income of retirees that was systematically invested in fixed income securities with record low yields. Now that inflation is on the upswing and markets are toying with the idea that the Fed is about to raise interest rates—even by a few basis points—the naysayers are warning that a crash in the economy and markets are right around the corner. Nobody is focusing on the fact that rising interest rates will likely help the elderly to improve their standard of living after so many years of low interest rates. Maybe somebody should!