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Two Kinds of Rich

There are two kinds of rich in the United States. The rich that are currently making it big, and the rich that are living on past accumulations of wealth. Who are these people? What are their goals? How so they spend money? How are they taxed?

Who are these people?

Those that are currently getting big rich I'll call the New Rich. They are the medical specialists, successful trial lawyers, successful entrepreneurs, owners of successful small businesses, and successful asset speculators. You probably know some of them. Almost every high school and college class has a few. Most are very bright and very hard working. A common trait is 60-90 hour work weeks, multiple college degrees, creative energy, and a desire to take risk and succeed. They embody the American dream, because a large percentage of them started with little more than their dreams and a willingness to work.

Those that live on accumulations of wealth I'll call the Asset Rich. They are members of families that have been wealthy for one or more generations. They may be well educated, but often they do not work or run a business in any way. The hard working Asset Rich often turn to politics or public service. The US Senate is full of these people. Many are behind the scenes investors. They are the object of envy and hatred by the lower classes, because they are viewed as parasites that did not earn what they have. They are the supposed target for "tax the rich" legislation, but this legislation rarely works and has little effect. Instead, the burden of "tax the rich" legislation is borne by the New Rich

As the very successful New Rich accumulate a lot of assets beyond their living needs, they join the Asset Rich crowd.

What are their goals?

There are several stages to wealth accumulation. First, the New Rich want to earn more than \$100,000 per year. At that level, all Social Security taxes are paid, and taxes on income drop fairly dramatically. Second, dividends bear no tax, and long term capital gains are taxed at 15%. Obviously, the second stage to get away from wage and salary income and convert to investment income. The third stage is to structure investments so that they generate tax credits and tax-free income. The fourth stage is to avoid transactions entirely thereby avoiding all taxes.

The New Rich want to become Asset Rich. They want to accumulate the trappings of wealth: mansions, expensive cars, airplanes, and access to the Asset Rich social register. Since, in many cases, they started with little they are aggressively making money and making risky investments. Most of their financial activities are in stages one and two.

The Asset Rich already a large accumulation of material wealth as a consequence of their birth. As a consequence, their principal goal is to maintain their assets. They do not have to take much risk, because a very low return on vast assets is easily enough to maintain a grand lifestyle. Most of their income is generated in stages three and four.

How do they spend money?

The New Rich are the embodiment of Ronald Reagan's "trickle down" economics. They spend a lot of money, and tend to make a lot of people around them very rich. Bill Gate's Microsoft Corporation created a few other billionaires and several thousand millionaires. They spend money on their business and personal life at a high rate, and often create new employment opportunities for thousands of people.

The Asset Rich are not big risk takers. Their goal is to grow their asset base in line with the overall economy...a few percentage points a year. They maintain their corporate interests and try to grow them in line with the overall economy. They may employ tens of thousands, but they create new employment opportunities at a much lower rate than the New Rich. Much of this is because their interests are so large that they cannot be managed any other way. They also do not need a lot of current income (as a percentage of assets). If you already own several mansions, expensive cars, and airplanes 5% of \$100,000,000 goes a long way.

How are they taxed?

These two classes of rich are taxed very differently. The New Rich need a lot of current income to build their wealth base. For a lifestyle equal to the New Rich, the Asset Class as described above need relatively little current income. Our tax system is based on the taxation of wages and transactions. The New Rich will have a lot of wage and transactional income. The Asset Rich can avoid wages and transactions, because they don't need the income.

The New Rich are the draft horses of both the economy and the income tax system. Much is made of the fact that the top 10% of taxpayers pay more than 50% of all taxes, and the New Rich bear a lot of that burden. The Asset Rich also pay a lot of taxes. But there is an interesting difference between the New Rich and the Asset Rich. 1% of the population holds nearly 40% of all wealth in the country. Those holders of 40% of the wealth only pay 13% of the income tax. They can avoid taxable transactions, and avoid taxes.

New Tax Policy

A lot of the recent presidential campaign rhetoric was about "taxing the rich" to close the deficit. Specifically, those making over \$200,000 per year were the target of these new taxes. My guess is that most of that target class are the New Rich. While both of the candidates came from wealthy families, George W. Bush paid an average income tax rate

of about 30%. The Kerrys paid an average tax rate of about 12% on a much larger income. The average New York City Fire captain paid a higher average tax rate than the Kerrys when you include both halves of Social Security and Medical taxes.

Any successful bill to promote tax reform should lower tax rates for most payers as well as simplify the system. None of the flat tax proposals by themselves meet this test. To accomplish this, it will take a new tax aimed at the Asset Rich class.