

# Do “The Wealthy” Pay Their “Fair Share” of Taxes in America?

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It should be no surprise to the reader of this essay that as a Wealth Manager, I serve affluent, or “wealthy” families, by assisting them in the management of their investible assets and estates. It’s been my privilege to do so for more than three decades. Unfortunately, in recent conversations with clients, and with other advisors serving this community, I’ve heard several complain that they are doing everything they can to avoid spending as they might have in the past, especially if their spending were conspicuous, or publicly noticeable. Some have cited the distain for wealthy Americans they see in the “main stream media”, telling me they feel like it’s never been less popular to be considered wealthy than it is today. With the recent rise of “populism” in America, there seems to be a growing sense in popular discourse that “the common man” has been oppressed by “the rich and powerful”, that power should be returned to the people, and that income should be more “fairly” redistributed. National media outlets are calling for the abolition of billionaires<sup>(1)</sup>, and some believe that “wealth is just evil”<sup>(2)</sup>. Being described as a “Socialist” is no longer an insult. In fact, a recent article in The Economist cited a Gallup poll of American millennials between the ages of 18 – 29, which found that 51% had a positive view of Socialism. In the primaries in 2016 more young folk voted for Bernie Sanders than for Hillary Clinton and Donald Trump, *combined*<sup>(3)</sup>.

This troubling trend isn’t just a phenomenon among millennials. Its occurring, albeit to a lesser degree, among Baby Boomers as well. The wealthiest among us have heard that message loudly and clearly, and for some, it’s led them to be more cautious in their public lives, to increase the security surrounding their homes, and to be more cautious in their public movements. To be described in public today as an “elite”, part of the “upper crust”, or as one of the “haves”, is no longer a compliment. In recent years, the phrase, “the One-Percenters” has become a term of derision, synonymous with the worst adjectives that could be used to describe the wealthiest among us. “One-Percenters” are often portrayed in public discourse as greedy, privileged people, heartless when it comes to the social safety net, and more specifically to the title of this article, as having access to “private” or “little-known” tax strategies that average Americans simply don’t have access to. These (imagined) strategies are presumed to allow the wealthy to avoid paying taxes altogether, or at least at a far lower rate than the average taxpayer. This sentiment is so commonly expressed in media today that I believe that most Americans in all economic strata believe it to be true.

While being “rich” has only recently become synonymous with being the American equivalent of a Russian Oligarch, for as far back as I can recall, politicians have been making the claim that “the

*wealthy don't pay their fair share*" of the nation's tax burden. And that particular phrase has been repeated so often in Washington D.C., and its truth so rarely challenged, it's easy to understand why there is a general acceptance among the populace that "*the tax system is rigged*" to favor the wealthy.

But is it?

In order to determine the truthfulness of such beliefs, one should first define the term "*wealthy*", and having identified who "*the wealthy*" are, one would then have to determine what constitutes a "*fair share*" of the nation's tax burden to be borne by these fortunate folks.

Wealth of course, is a relative term, and while the dollar amount that constitutes "*wealth*" may differ from person to person, I've observed that it's almost universally believed by Americans that the wealthy are anyone who makes more than them! For purposes of this discussion, however, I'll suggest that those whose earnings fall into the top 10% of Americans are "*affluent*", and those whose earnings fall into the top 1% are "*wealthy*".

What Americans believe constitutes a "*fair share*" of the nation's tax burden is far more subjective, and less easily quantifiable than wealth or affluence, as it depends upon the citizen's perception of fairness, and of equity. To some degree, it's also subject to their beliefs around taxation as a means of reducing income inequality in a capitalist system, about wealth redistribution, and about the current state of economic mobility in the country. If you are one who believes that hard work, entrepreneurship, and risk taking should be incentivized, and financially rewarded, you probably feel differently about taxation than those who feel that the system is rigged to prevent upward economic mobility among the "*have nots*".

The truth is that Americans are subject to lots of different taxes today. Federal, State, and local governments depend upon tax revenues to fund their operations, and have shown themselves to be extremely "*creative*" in discovering new entities and activities to tax. We pay Sales Taxes, Property Taxes, Rental Taxes, Gift or Estate Taxes, Payroll Taxes, Excise Taxes, Fuel Taxes, Luxury Taxes, Hotel Taxes, and "*Sin*" Taxes, among others. But by far the largest single source of Federal Tax revenues are the Individual and Corporate Income Taxes, which provide 47.9% and 9.0% of the Federal Governments' revenues respectively. In 2017, the U.S. Federal government collected revenues of \$3.3 Trillion, with \$1.88 Trillion of that sum coming in the form of Individual and Corporate Income Tax remittances. <sup>(4)</sup>

Like most of the world, our country has a "*progressive*" Income Tax Code, which means that the higher your taxable income, the higher the rate of taxation applied to that income. There are some, albeit a small minority of Americans, who advocate for a "*flat tax*" rate, a tax rate applied to every

dollar of income, regardless the amount. Advocates for our progressive tax system believe that a “flat tax” system places an undue burden on the lower and middle classes, since the “flat” tax rate that would be required to fund the government’s spending would have to be higher than proponents of our current tax system feel could be borne by the “non-wealthy”. The truth is, if you have discretionary income, and are willing to defer it’s use for a period, there are legal ways to “shelter” some of the income subjected to the highest tax brackets. And as I stated previously, its commonly believed that “the wealthy” use these legal strategies and structures to reduce, or even eliminate their tax burden. All that said, I believe many Americans would be surprised, and perhaps even shocked to find out who pays the nation’s Income Taxes.

Fortunately, we don’t have to wonder. We have the Tax Foundation, an independent, non-partisan and nonprofit tax policy organization based in our nation’s capital to provide us with cold, hard facts on the matter. Each year, the good folks at the Tax Foundation scour all the personal income tax filings to the IRS, and they put together a report that’s available on their site. The most recent compilation of this data (“*Summary of the Latest Federal Income Tax Data, 2018 Update*”) was published in November 2018, based upon the 2016 Federal Individual (personal) Income Tax filings <sup>(5)</sup>.

Here are the “high level” findings of the report:

- In 2016, 140.9 million American tax filers reported earning a combined \$10.2 Trillion in Adjusted Gross Incomes, and they collectively paid \$1.4 Trillion in individual income taxes to the U.S. Treasury.
- The amount of reported income earned by the top 1 percent of American taxpayers fell slightly in 2016 from the prior year, to annual earnings of \$480,804 or more. Collectively, these “one-percenters” claimed 19.7 percent of all Americans’ earnings in 2016. Contrary to popular belief, their “share” of all Americans’ federal individual income taxes paid was almost twice their share of the income, at 37.3 percent. In fact, the top 1 percent paid a greater share of the country’s individual income taxes than did the bottom 90 percent of Americans, combined (30.5 percent).
- In 2016, the top 50 percent of all wage earners in America paid 97 percent of all individual income taxes, while those with earnings placing them in the bottom 50 percent, paid the remaining 3 percent of income taxes paid.
- The top 1 percent of taxpayers paid an “effective” (on every dollar of earnings) individual income tax rate of 26.9 percent, which is more than seven times higher than the “effective” tax rate paid by taxpayers in the bottom 50 percent (3.7 percent).

Those are data you don't hear cited by many politicians today. It certainly doesn't fit the narrative that "the wealthy don't pay their fair share" of the nation's tax burden. Here's a chart from the report that slices the data in ways its relatively easy to identify the "affluent" (top 10% of wage earners) and the "wealthy" (top 1% of wage earners) Americans' shares of the nation's income, and their corresponding shares of the nation's tax burden:

## Summary of Federal Income Tax Data, 2016

	Top 1%	Top 5%	Top 10%	Top 25%	Top 50%	Bottom 50%	All Taxpayers
Number of Returns	1,408,888	7,044,439	14,088,879	35,222,196	70,444,393	70,444,393	140,888,785
Adjusted Gross Income (\$ millions)	\$2,003,066	\$3,574,828	\$4,729,405	\$6,950,051	\$8,979,705	\$1,176,907	\$10,156,612
Share of Total Adjusted Gross Income	19.72%	35.20%	46.56%	68.43%	88.41%	11.59%	100.00%
Income Taxes Paid (\$ millions)	\$538,257	\$839,898	\$1,002,072	\$1,240,010	\$1,398,523	\$43,863	\$1,442,385
Share of Total Income Taxes Paid	37.32%	58.23%	69.47%	85.97%	96.96%	3.04%	100.00%
Income Split Point	\$480,804	\$197,651	\$139,713	\$80,921	\$40,078		
Average Tax Rate	26.87%	23.49%	21.19%	17.84%	15.57%	3.73%	14.20%

Note: Table does not include dependent filers. "Income split point" is the minimum AGI for tax returns to fall into each percentile.  
Source: IRS, Statistics of Income, Individual Income Rates and Tax Shares (2018).

Chart Source: Tax Foundation: Summary of the Latest Federal Income Tax Data, 2018 Update

It may be reasonable to find it troubling to discover that the top 1% of wage earners in America in 2016 earned 19.72% of all the nation's income, while the bottom 50% of wage earners earned just 11.59% of the country's income. Income inequality like that can be stark, especially when one considers that many Americans in the bottom half of wage earners work quite hard, and in some cases, more than one job. I'm sure we'd like all Americans to earn a living wage, and for everyone to have upward economic mobility, but regardless the cause for such income disparity, any objective reading of that data would have to conclude that at 37.32% of the total tax burden, the "one-percenters" certainly pay their fair share of the country's taxes. As stated earlier, their "share" of the country's tax burden is almost twice as high as their "share" of the nation's income. The same could be said of "affluent" Americans (incomes greater than \$139,713 in 2016), who collectively earn 46.56% of the nation's income, but bear 69.43%, or 50% more of the tax burden. Is that a "fair share" of the country's tax burden? I'll let the reader decide.

If you are an Arizona resident, as most of my clients and friends are, today (April 9<sup>th</sup>) is a special day! Last year (2018), today was "Tax Freedom Day" in our State. It's a significant day because it represents how long Arizonans must work during the calendar year in order to pay their (combined) federal, state, and local taxes of all types. Great news, taxpayers, you'll likely get to keep the rest of your wages the rest of the year!

Relative to many other States, Arizonans are quite fortunate, in that our tax burden tends to fall on the lower end of the list of States by tax burden, typically providing us with one of the earliest Tax Freedom Days on the calendar. The least taxed States last year, Louisiana and Alaska, tied for 1<sup>st</sup>, celebrating the earliest Tax Freedom Days among the States, gaining their “freedom” on April 4<sup>th</sup>. The state with the largest tax burden, and, the latest Tax Freedom Day on the calendar last year belonged to citizens of New York State (50<sup>th</sup>), who’s citizens weren’t “free” of their 2018 tax burden until May 14<sup>th</sup>, followed by New Jersey and Connecticut, who tied at 48<sup>th</sup>, (May 3<sup>rd</sup>). Nationally, Tax Freedom Day fell on April 19<sup>th</sup> last year, 109 days into the calendar year. Here’s a map of the United States, with each State’s (2018) “Tax Freedom Day”.<sup>(6)</sup>

## When Does Tax Freedom Day® 2018 Arrive in Your State?

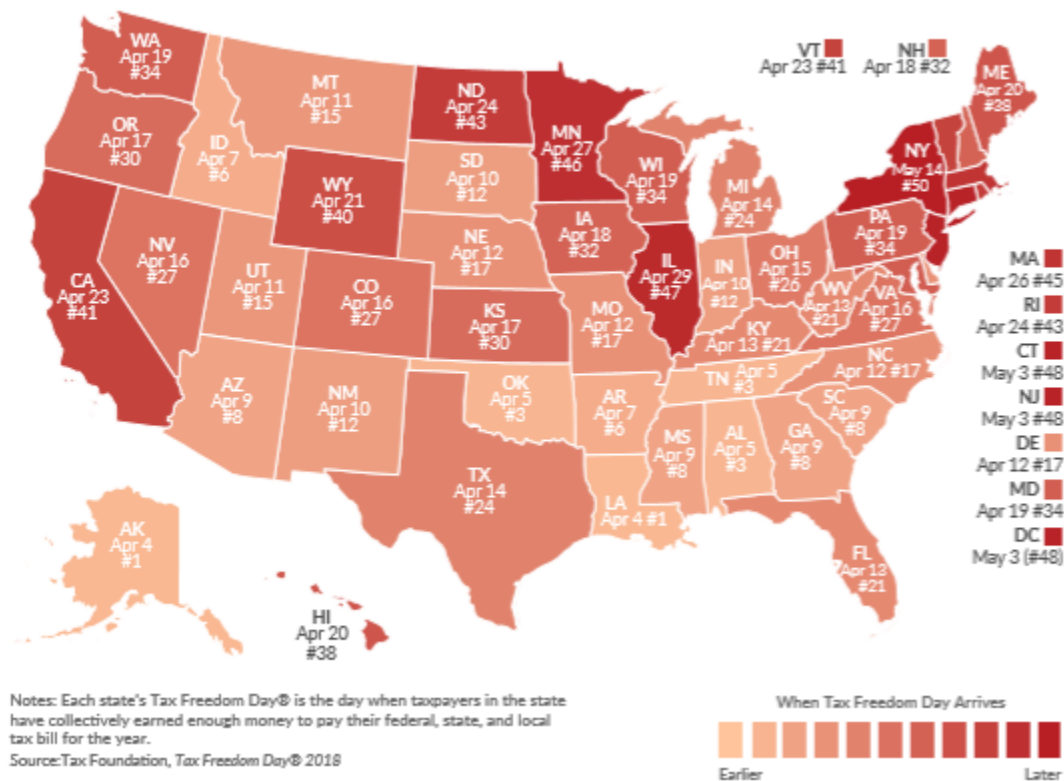


Chart Source: Tax Foundation; “Tax Freedom Day” 2018 is April 19<sup>th</sup>”

Keep in mind that these “Tax Freedom” dates consider all taxes born by the citizens of each State, not just those applied to income, but I find it striking that when we look at the myriad taxes that are applied, more than one quarter of all the earnings of the country find their way into government hands. For those “affluent” who find themselves in the top decile of the country’s earnings, or the

“wealthy” in the top 1 percent of earnings, given their disproportionately high “share” of the nation’s tax burden, it’s mathematically certain that their individual Tax Freedom Days come even later in the year than the dates shown above. We don’t know what 2019’s Tax Freedom Day is yet, but with the severe limitations placed on the deduction of State and Local Taxes (“SALT” Deductions) contained in the most recent tax reform bill (7), folks in the highest income brackets (> \$1 million a year) in New York, Connecticut, New Jersey and California can find themselves effectively paying more than 50 percent of their gross earnings in taxes.

Is that “fair”? I’ll leave it up to the reader to decide for themselves, but let me close by saying that it is not a coincidence that many of these high tax States are experiencing “net outflows” of their populations, especially among their wealthiest citizens, who at some point decide that being the “minority partner” in the harvesting of the fruit of their labors, is unacceptable. Say what you want about the benefits of a social safety net, about income inequality, about the need for more government revenues, about growing government deficits, or about the “fairness” of a progressive tax system, but in this writer’s humble opinion, the government should never get more than half of a person’s labor. Think about it.

As always, we welcome your comments and questions as the calendar counts down to 2019’s Tax Freedom Day.



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- (1) <https://www.nytimes.com/2019/02/06/opinion/abolish-billionaires-tax.html>
- (2) <https://nypost.com/2019/02/03/the-left-has-decided-wealth-is-just-evil/>
- (3) <https://www.economist.com/leaders/2019/02/14/millennial-socialism>
- (4) <https://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-federal-government>
- (5) <https://files.taxfoundation.org/20181113134559/Summary-of-the-Latest-Federal-Income-Tax-Data-2018-Update-FF-622.pdf>
- (6) <https://taxfoundation.org/tax-freedom-day-2018/>
- (7) "Tax Cuts and Jobs Act", signed into law on December 22nd, 2017

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