RUTH PADAWER: Sugar Daddies 2.0 **WYATT MASON:** The Poet Laureate of High *Louche*

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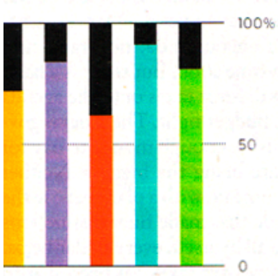
The Way We Live Now

TAX POLL

Percentage of male, female, Republican, Democratic and Independent survey respondents in New York State who support raising the state income tax paid by people who earn more than $1 million a year:



Source: Quinnipiac University poll, February 2009

Richly Undeserved

The well off are not the wealthy. So why tax them as if they were?

By David Leonhardt

This is not the easiest time to be rich. Not so long ago, the image of American wealth was a heroic one, embodied by figures like Bill Gates and Jack Welch. Today it tends toward the corrupt or at least the hapless: Bernie Madoff, the traders at A.I.G., the former Lehman Brothers chief executive mocked on Capitol Hill, the General Motors chief executive fired by the White House.

The economic problems of the wealthy have tracked pretty closely with their image problems. Stocks are way down, and the waning days of the 2009 tax season offer reason for one more headache: taxes on the rich won't stay this low for very much longer. In 2011 the Bush tax cuts will expire, and President Obama plans to also close various loopholes. As Peter Orszag, Obama's budget director, delicately says of the rich, "We are asking them to pitch in a bit more." The current moment has the feel of an inflection point for the American wealthy, like the stock-market crash of 1929 or the election of Ronald Reagan in 1980.

But inflection points can be misleading. Even on the rare occasions when they occur, they often bring about less change than at first it seems. The mere fact of change is so startling that the magnitude of that change can become exaggerated. So it is with Obama's approach to the wealthy, especially on taxes. His agenda is a bold one in many ways. Yet his tax code would still look more kindly on wealth than Nixon's, Kennedy's, Eisenhower's or that of any other president from F.D.R. to Carter. And only part of the reason for this is widely understood.

It's well known that tax rates on top incomes used to be far higher than they are today. The top marginal rate hovered around 90 percent in the 1940s, '50s and early '60s. Reagan ultimately reduced it to 28 percent, and it is now 35 percent. Obama would raise it to 39.6 percent, where it was under Bill Clinton.

What's much less known is that those old confiscatory rates were not as sweeping as they sound. They applied to only the richest of the rich, because yesterday's tax code, unlike today's, had separate marginal tax rates for the truly wealthy and the merely affluent. For a married couple in 1960, for example, the 38 percent tax bracket started at $20,000, which is about $145,000 in today's terms. The top bracket of 91 percent began at $400,000, which is the equivalent of nearly $3 million now. Some of the old brackets are truly stunning: in 1935, Franklin D. Roosevelt raised the top rate to 79 percent, from 63 percent, and raised the income level that qualified for that rate

David Leonhardt is an economics columnist for The Times and a staff writer for the magazine.

Photograph by Jessica Craig-Martin

to $5 million (about $75 million today) from $1 million. As the economist Bruce Bartlett has noted, that 79 percent rate apparently applied to only one person in the entire country, John D. Rockefeller.

Today, by contrast, the very well off and the superwealthy are lumped together. The top bracket last year started at $357,700. Any income above that — whether it was the 400,000th dollar earned by a surgeon or the 40 millionth earned by a Wall Street titan — was taxed the same, at 35 percent. This change is especially striking, because there is so much more income at the top of the distribution now than there was in the past. Today a tax rate for the very top earners would apply to a far larger portion of the nation's income than it would have years ago.

No one in the Obama administration or Congress has suggested taking rates back to their sky-high pre-Reagan levels. But a tax code that drew a sharper distinction between the upper middle class and the extremely wealthy, while keeping its top rate below, say, 50 percent, seems more conceivable. Last year, the House of Representatives passed a surtax on incomes above $1 million to pay for G.I. benefits. (It went nowhere in the Senate, where — relevantly or not — many members would be affected by such a tax.) Gene Sperling, now a top Treasury Department official, once raised a similar idea, to shore up Social Security.

The argument against such increases is not insignificant. Conservative economists say that higher tax rates could damage the economy and ultimately be self-defeating, because they would give the rich an incentive to shift their pay into stock or other investments that are taxed less. And to some degree, such shifting would surely happen.

But one economic lesson of the last couple of decades is that these responses are fairly modest. An academic study of the Clinton tax increases found that they caused corporate executives to exercise some stock options earlier than they otherwise would have. But the increases had no noticeable long-term effect. The executives didn't ask to be paid entirely in stock, and the economy boomed. Increasing taxes on the rich, in other words, has some unintended consequences, but it mainly has the intended ones: it raises revenue and reduces inequality. That study was written by Austan Goolsbee, a University of Chicago professor who later became the first economic adviser to a Senate candidate named Barack Obama.

Given the opposition that some of Obama's existing tax proposals have encountered, no grand new proposals are likely anytime soon. But there is a basic economic reality that will force taxes onto the agenda well beyond this year's budget fight. The federal government simply isn't raising enough money to pay for its obligations, Medicare being the biggest. Neither political party has yet come up with a plan to close the gap. Although a tax code that made finer distinctions would not close the gap all by itself, every dollar helps.

For 30 years, the debate over taxes has been shaped by a faith that a flatter code is always better. There is little reason to believe that and every reason to believe that tax brackets, as well as tax rates, should be part of the coming debate. ■