Travelers to Mexico are often treated to entertainment; a young diver displays his or her skills by diving off a high cliff into the ocean. The media has sounded the alarm for early 2013 when a different type of cliff diving may occur. That is when a number of taxes, presently abated, are scheduled to increase coinciding with curtailed government spending. According to FED Chairman Bernanke, “…there’s going to be a massive fiscal cliff of large spending cuts and tax increases.”

What would the end of the “Bush Tax Cuts” look like? Significant changes will take place. The top tax rate on income will rise from 35% to 39.6%. Dividends and capital gain will also be impacted. Top earners will find their dividends taxed at a confiscatory 39.6% rate, up from 15%.

The new health care law, popularly known as “ObamaCare”, adds another layer of new taxes. For those making over $250,000 there is a new 3.8% Medicare surtax on investment income. This will be coupled with an additional 0.9% tax on earned income.

Taxes play an important role in our economy. In 1963 President John F. Kennedy showed keen insight noting, “It is a paradoxical truth that tax rates are too high today, and tax revenues are too low and the soundest way to raise the revenues in the long run is to cut the tax rates. ... [A]n economy constrained by high tax rates will never produce enough revenue to balance the budget, just as it will never create enough jobs or enough profits.”

Our research shows the wisdom of President Kennedy’s words. We examined all of the individual states tax codes and their impact on the entrepreneur class. The data are impressive.
It suggests those states employing the lowest tax burden enjoys the best employment, economic growth, and fastest tax revenue growth. Indeed, the truth is a rising tide lifts all boats but looming tax increases may lead our nation’s economic ship to run aground.

It would be easy to panic here. But after 40 years serving clients, we have uncovered few bounds on the ability of politicians to reverse previous positions where their constituent’s interest is involved and pressure is applied. We are confident they won’t tolerate being blamed for the next recession. Congress and the President often disagree, but they have developed great rapport and expertise in “kicking cans,” (deferring hard decisions.) It may not speak well for politician’s consistency, but we look for yet another partial “fix” to be engineered with few really significant long term solutions being applied.

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