



## Taxes: What Should We Believe?

We have heard a lot of outrage in the news recently regarding Mitt Romney's low tax rate of 15%. Unfortunately, these articles rarely explain the tax code behind these rates. In reality, Mitt is accurately following our current tax law, as we all would in his situation. Taxes on income are broken down into two main categories: taxes on "ordinary income" (wages, salary, bonuses, commissions, interest, etc), and preferential taxes on capital gains & qualified dividends (earnings derived from gains and dividends on capital assets such as stocks, bonds, real estate, businesses, equipment, etc.). Currently, the tax on capital gains & qualified dividends is historically low, and in fact, for 2012, is actually 0% for taxpayers in the 15% or lower federal tax bracket, and 15% for those in all higher tax brackets. Contrast those rates with ordinary income tax rates which range from a low of 10% for the lowest income earners to a high of 35% for the highest income earners, and you begin to get an idea of where the disparity of taxes comes from.

While this perceived disparity may cause us distress, the truth of the matter is that many of these high earners have already paid taxes on their income at ordinary income tax rates. It is often these post-tax monies that are then invested in capital assets requiring the payment of a capital gain or dividend tax when a gain is realized or a dividend received. (The intent of lower capital gains and dividend tax being to encourage investment in business.) While a discussion about the fairness of the tax code is always relevant, it should be done with a clear understanding of the facts. It is worth noting that these current tax rates were originally put in place by the Bush administration, and were originally set to sunset in 2010. They were extended for 2 years by the Obama administration in hopes of stimulating the economy through consumer spending. While there will certainly be much discussion amongst both parties regarding the "fairness" of the current tax rates, don't expect action on this issue until after the election in November at the earliest. If Congress fails to act, the current tax rates will automatically sunset at the end of 2012, increasing the ordinary income tax rates as well as the capital gains and dividend tax rates.

Fortunately, you don't have to have a net worth on the par of Mitt Romney to take advantage of the current tax code. The average taxpayer may be able to capitalize on the current low capital gains rates as well. If you have large gains in your investment accounts, realizing them in 2012 may allow you to pay the preferential 15% federal tax on the gains. If your income falls in the 15% or lower tax bracket, you may be able to realize capital gains and pay no federal tax on it at all. (Note: capital gains are included as ordinary income for Oregon state tax and will be taxed as such.)

One final thought on our current tax situation. As most of you know, I regard Social Security as an extremely valuable (and somewhat sacred!) program, so I am troubled about the recent news reports regarding the payroll tax. First of all, the payroll tax is a tax on earned income and is used to fund the Social Security program. The 2% reduction implemented in 2010, which was a give-a-way from the Obama administration to the Republicans in exchange for extending unemployment benefits, was intended to be a one-year temporary reduction only. The reduction has been extended in hopes that it will spur the economy by encouraging consumer spending. Unfortunately, when the time came to let the 2% reduction expire, it was touted by some as a "tax increase", a gross distortion of the facts. Please do not attach any legitimacy to these types of claims. We should all support this program, as it will provide us all with benefits someday. To many, it will keep them out of poverty. As such, it provides one of the best means a developed country such as ours has of taking care of its citizens in their later years.

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