Victoria Capital Management, Inc.

Market Musings

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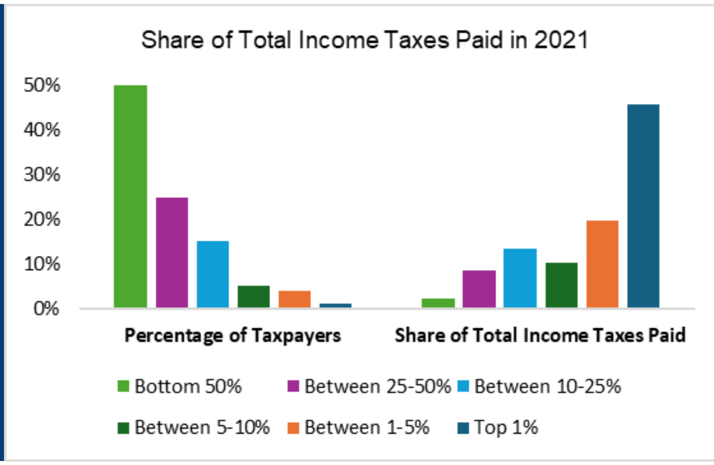
The chart reflects the share of taxes paid by each income bracket as of the latest available data in 2021. The bottom 50% of the population pays a small amount of taxes, while the top 1% pays almost 50% of total Federal income tax revenues. Fairness is in the eye of the beholder!

Data Source: Tax Foundation



"We can draw lessons from the past, but we cannot live in it."

- Lyndon B. Johnson

A Look at the "Fairness" of Personal Income Taxes

Recent discussions have centered on the idea that personal income tax rates are unfair and that a dramatic rate increase on the "rich" will solve the problem. The personal income tax was introduced in 1913 at a level of 7%. That rate was raised to 94% during the Franklin Roosevelt presidency in 1944. Incidentally, President Roosevelt proposed a 100% tax rate for all income over $29,000! In the 1950s, the maximum personal income tax rate was 92%. President Johnson lowered that rate to 70% in 1965. The next significant change was at the beginning of the Reagan administration when personal income tax rates were reduced to a maximum of 50%. In 1988, Reagan again lowered tax rates to 28%. Over the ensuing 40 years, depending on the administration, income tax rates have fluctuated from that low point under Reagan to today's maximum income tax rate of 37%. This November election portends that tax rates may change dramatically depending on the outcome.

One challenge for investors is determining how tax rate changes will impact financial markets. In the process, the question arises as to what "fairness" means in structuring a tax system. According to the IRS, "A concept of tax fairness that states that people with different amounts of wealth or different amounts of income should pay tax at different rates." This definition implies that there could be a massive redistribution of wealth to provide equality.

There are two proposed major tax changes. One proposal is increasing the maximum tax rate for individuals and corporations. The idea is to transfer money from one economic sector to another by raising these tax rates. However, if marginal tax rates are too high, the government will likely collect less, not more, revenue. This basic theory underlies Supply-side economics. In the extreme, imagine Congress approving President Roosevelt's 100% personal income tax rate. Tax collections would probably collapse. So, manipulating tax rates could produce unintended consequences. The other proposal is to impose tariffs across the board that could drive prices and inflation higher, which would undoubtedly shift the burden of such a "tax" to the middle and lower classes, which depend on cheaper imports to maintain their standard of living. The upper classes would be least affected by such a tax increase. In either case, these proposals could make the idea of fairness a distant memory.

Market Commentary

August was choppy for global equities. Domestically, large-cap stocks outperformed mid-and small-cap stocks, which declined. Across the pond, European equities (the S&P Europe 350) recovered a 6% drop in early August to close the month higher. Fifteen of sixteen countries in the index had positive returns. Japanese stocks fell on the back of a rate hike from the Bank of Japan that resulted in an unwinding of Japanese yen carry trades. The S&P/TOPIX 150 dropped 13% on August 5th but bounced back to finish down 3%. Most other Asian country indices were higher. Latin American indices had mixed results, but the region is still down double-digits this year. Domestic bonds rallied based on interest rate-cut expectations while the U.S. dollar remained stable.

According to the IDC, Worldwide spending on AI and AI-enabled technologies will exceed $630 billion by 2028 for an annualized growth rate of 29%.