STUDY GUIDE

DO THE RICH PAY THEIR FAIR SHARE?

KEY TERMS: taxes, payroll tax, rich, income, fair

NOTE-TAKING COLUMN: *Complete this section during the video. Include definitions and key terms.*	**CUE COLUMN:** *Complete this section after the video.*
Who is considered 'rich'?	What is the difference between lower-income earners and higher-income earners in terms of the ratio of income earned to taxes paid?
What metric does Prof. Ohanian explain would seem 'fair' in terms of taxation of personal income?	At the end of the video, Prof. Ohanian concludes that, "It may feel good to take even more money from the top ten percent, but it doesn't do good. And it sure isn't fair." What does he mean by this?
What do studies show happens when the tax rate is too high? Who suffers?	

DISCUSSION & REVIEW QUESTIONS:

- What do you think motivates many people to claim that the rich don't pay their fair share? Do you agree with the claim?

- How would you approach the task of defining 'who is rich' and 'what is fair' in terms of income and taxes for Americans? Do you agree with Prof. Ohanian's approach? Why or why not?

- Prof. Ohanian informs us that of the total taxpayers, 47% of them make $45,000 or less and "...pay little and often no income taxes." How would you explain why this is the case?

- In the video, Prof. Ohanian compares our "...substantially more progressive..." tax system to other advanced countries. Does this evidence help support Prof. Ohanian's claim that the rich in our country pay "...more than their fair share?" Explain how it does or doesn't.

- We learn in the video that high-income earners pay a significantly larger amount of money in taxes to the government than low-income earners, and that the high-income earners also greatly subsidize entitlement programs that many low-income earners depend on later in life (such as Social Security and Medicare). Do you consider this condition to be fair? Do you believe that this information solidly refutes the claim that the rich do not pay their fair share?

- If you could unilaterally change the individual income tax system, or at least change the percentages, what changes would you make? Why?

EXTEND THE LEARNING:

CASE STUDY: Warren Buffet

INSTRUCTIONS: Read the article, "Warren Buffett's Actual Tax Rate Much Closer To 31%, While His Office Workers Pay 21%," then answer the questions that follow.

- Which important factors did Mr. Buffet leave out of his analysis and claim?

- Do you agree with the author's analysis? Why or why not?

- Would you consider Mr. Buffet rich? By which definition? Do you think he pays his 'fair share' in individual income taxes? By which measure?

http://www.forbes.com/sites/realspin/2013/10/23/warren-buffetts-actual-tax-rate-is-31-while-his-office-workers-pay-21/

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Warren Buffett's Actual Tax Rate Much Closer To 31%, While His Office Workers Pay 21%

Berkshire Hathaway Chairman and CEO Warren Buffett. (Image credit: Getty Images via @daylife)

By George P. Harbison

In August, 2011, Warren Buffett wrote an opinion piece in the *New York Times* in which he made the assertion that his 2010 "federal tax rate" of 17.4% was 18.6 percentage points less than the 36.0% average rate paid by the twenty other workers in his office.

Buffett's piece garnered substantial media attention and, in the months since its publication, his "federal tax rate" assertion has been woven into the fabric of American politics. His analysis was the basis for the "Buffett Rule," a tax plan proposed by President Obama that would implement measures under which everyone making more than $1 million in income per year would pay a minimum effective tax rate of 30%.

Clearly, given Buffett's status as a legendary businessman and investor (the "Oracle ORCL +0.00% of Omaha"), his tax analysis carried a great deal of credibility and, as such, it was never challenged. Adding to the unchallenged acceptance of Buffett's assertion was the fact that Buffett never released (a) his 2010 federal tax return, (b) the federal tax returns of his office workers, and (c), the analysis underlying has "federal tax rate" assertion.

In truth, Buffett's assertion is completely inaccurate and is based on a fundamentally flawed analysis of basic federal taxation principles. In reality, he pays a much higher relevant "federal tax rate" than any of his office workers.

First of all, payroll taxes (Social Security and Medicare) are totally irrelevant for this type of analysis. Because these taxes were not assessed on non-wage income, and because Social Security taxes were only assessed on the first $106,800 of wage income in 2010, the amount Buffett paid into these programs was very close, in dollar terms, to the amounts paid into them by each of his office workers. But because Buffett had total taxable income of almost $40 million, the amount of Social Security and Medicare taxes paid by him in 2010 represented a tiny fraction of his total taxable income. For most of his office workers, these taxes represented 7.65% of their taxable income (even though they paid roughly the same amount as Buffett did in dollar terms). This 7.65% payroll tax differential is part of the 18.6% differential cited by Buffett in his Op-Ed piece.

But what Buffett failed to mention is the fact that Social Security and Medicare benefits are capped as well. Upon retirement, Buffett will receive almost exactly the same Social Security and Medicare benefits that his office workers will receive. There is very little differential between Buffett and his office workers in terms of what they pay into the Social Security and Medicare programs, and what they will receive in benefits. As such, the 7.65 percentage point "federal tax rate" differential between Buffett and his co-workers arising from the existing Social Security and Medicare taxing mechanism is simply not relevant, and is a mirage.

A second flaw in Buffett's analysis has to do with the fact that he included employer-paid payroll taxes in coming up with his and his office workers "federal tax rates." The problem is that Buffett's co-workers do not pay these taxes, rather Buffett does as a partial owner of Berkshire Hathaway BRK.A +%. Buffett's inclusion of these "taxes" into his analysis was incorrect and distorts the rates he cited. Of course, he included employer-paid payroll taxes to double the 7.65% "federal tax rate" differential mirage identified in the previous paragraph.

Buffett himself owns 33.9% of Berkshire Hathaway, a publicly traded corporation with taxable income of $19.1 billion in 2010. Assuming a conservative corporate federal tax rate of 25%, Berkshire will ultimately pay $4.76 billion in federal corporate income taxes on this taxable income. Corporate taxes are borne by shareholders of the corporation, in that these taxes reduce the amount of cash available for (a) dividend payments (Berkshire has not historically paid dividends to its shareholders), or (b) reinvestment into the corporation in order to drive shareholder value.

Given his ownership stake in Berkshire, 33.9% of the $4.77 billion in federal corporate taxes, or $1.61 billion were borne by Buffett. Buffett ignored this tax amount in compiling his "federal tax rate" analysis. If Buffett's share of corporate taxable income and corporate taxes paid are factored into his analysis, his overall "federal tax rate" increases from by 7.56 percentage points, from 17.4% to 24.96%.

As an employer, Berkshire matches the Social Security and Medicare taxes paid by its employees. These taxes are covered by the shareholders of Berkshire for the same reasons corporate income taxes are. Using reasonable assumptions and data gleaned from the company's 2010 SEC filings, Buffett's share of these taxes was approximately $400 million in 2010. If these taxes are included (and they certainly should be), his 2010 federal tax rate increases by 6.16 percentage points to 31.12%.

Let's do the math. Buffett, in his analysis, overstated his office workers' "federal tax rate" by including irrelevant payroll taxes (7.65%) and employer-paid payroll taxes (7.65%). In actuality, his office workers' relevant 2010 "federal tax rate" was 20.7%, not 36.0%.

Buffett, in his analysis, ignored his share of corporate income taxes paid by the company he owns a third of. By doing so, he understated his "federal tax rate" by 7.56 percentage points. In addition, he ignored his share of Social Security and Medicare taxes paid by Berkshire. In doing so, he understated his "federal tax rate" by an additional 6.16 percentage points. If you're keeping score, Buffett's relevant 2010 "federal tax rate" was actually 31.1%, not 17.4%.

Bottom line: Buffett's 2010 relevant "federal tax rate" was actually at least 10.5 percentage points higher than the average rate paid by his office workers.

Who knew?

It is quite troubling that Buffett's original *Times* op-ed piece, based upon such a flawed and very incomplete analysis, has gained such unchallenged visibility and credibility within the landscape of American politics. While Buffett should be chastised for putting out such an inaccurate and misleading analysis, political commentators on the right should be faulted for not doing their research and for not effectively raising a challenge against the flawed thinking underlying Buffett's op-ed.

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