



THE FUTURE OF US TAXATION: *And how to prepare*

BY NICK STOVALL, CPA/PFSSM, MBA



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The last time I wrote about the future of U.S. taxation we were facing a Fiscal Cliff and had just finished raising the debt ceiling from a statutory perspective for the 93rd time since June 25, 1940. Sadly, that's an average debt limit increase of roughly 1.3 times per year. Since this time, we have had three further debt ceiling increases with the most recent increase having no stated limit and only an expiration date of March 16, 2015.

Everyone has gone over the Fiscal Cliff resulting in increased taxes, the Patient Protection and Affordable Care Act has gone into effect resulting in additional taxes, and sequestration almost brought the government along with society to its knees. Of course, I proffer that last bit with tongue-in-cheek as nobody really remembers what programs were cut, or will be cut, from the federal budget.

The phrase “nothing can be said to be certain, except death and taxes” was coined from a letter written by Benjamin Franklin to Jean-Baptiste Leroy in 1789 as an off-kilter reference to the newly established Constitution of the United States and has held an unenviable truth ever since. However, due to recent upheavals in the American financial landscape, this saying might need to be modified to “nothing can be said to be certain, except death and increasing taxes.”

With the well-being of our economy in jeopardy, legislation regarding debt reduction and tax reform has become a hot button issue. Regardless of which legislation has been, or will be, thrown at us, the truth of the matter remains the same: our current tax revenues cannot cover our obligations.

If our government wants to keep the lights on, then it is going to need more income, which not only means that you can count on being taxed, but also on being taxed at an increasing rate.

Debt Ceiling – Cause and Effects

The continual increasing of the debt ceiling has raised

more than just the ability for our government to go further into debt; it has raised concerns and fears about the future of our economy. We continue to see major swings in the markets with investors showing serious concerns over the future of investment valuations and their personal wealth. Unfortunately, the reasoning behind all of this uncertainty is preceded by the inability to see the full implications of what is to come. I say this because what is little talked about, coupled with all the discussions and decisions on raising the debt ceiling, are the discussions on tax reform that are, and will be, inevitably required to correct the problems that lie beneath the need for the debt ceiling increases.

Increasing the debt ceiling is needed because the government keeps maxing out its credit limit, which it has been reliant upon since the Industrial Revolution began. It is really not much different than what we have been seeing from the general public for the past few decades. Unfortunately, most of us do not have the ability to get a credit limit increase on a credit line once it has reached the maximum limit unless we can show we have the ability to pay the balance back. The only way to pay this credit line back is by making more money than we spend. In another sense, becoming responsible and balancing our budgets.

The federal government keeps finding ways to increase its credit line without also finding ways to proportionally cut its spending. Although we put legislation in place to give the appearance of spending cuts through future sequestration, the politicians in charge still find a way to reduce the cuts. The government keeps increasing its credit limit, but in order to get things back in balance, it is in desperate need of finding ways to decrease spending and make more money. Sadly, spending cut discussions rarely have a positive outcome and, even then, the general public is subdued with endless propaganda about how controlling spending will destroy life as we know it. Consequently, the only way for the government to compensate for its lack of spending cuts is by making more money. However, the only way the government

makes money is by collecting taxes. Unfortunately, at the current moment, the government collects approximately \$42 billion less per month than it spends¹.

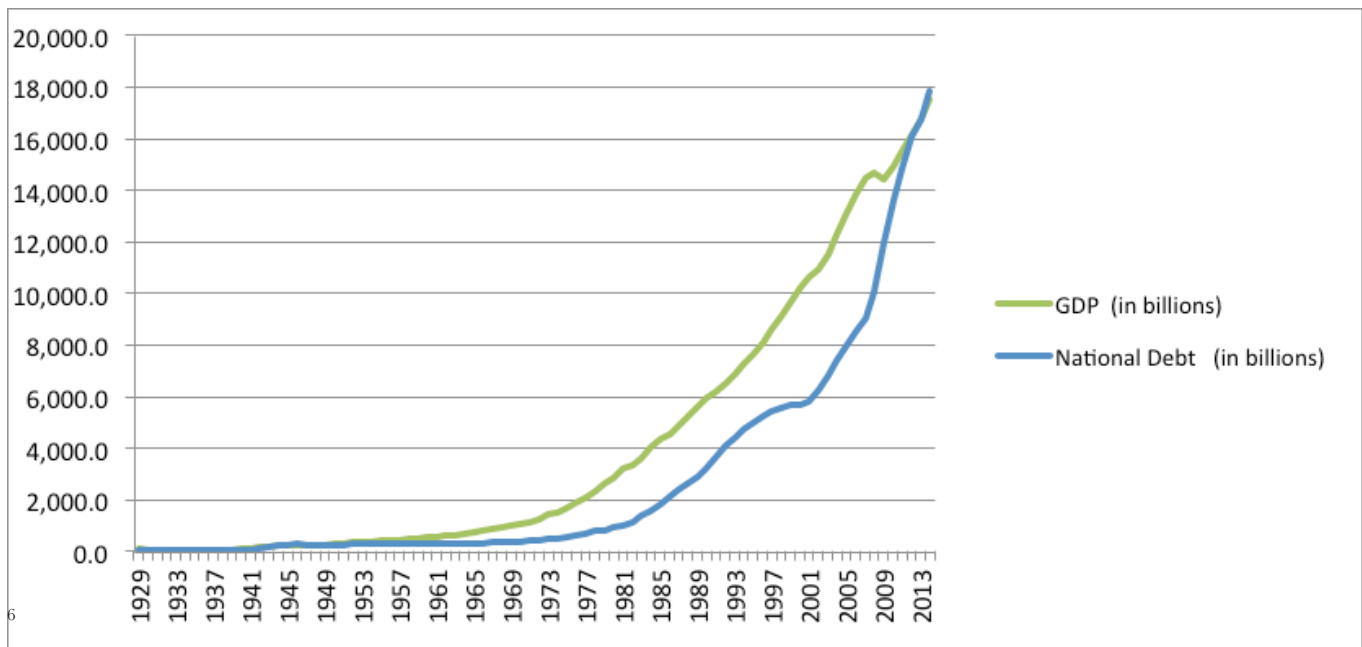
Debt and Earnings

Let us take a closer look at where we are today. The national debt is increasing at an unprecedented rate, rising to levels never seen before and threatening serious harm to the economy. In October 2004, the national debt was \$7.4 trillion², and by October 2014, it had climbed to \$17.9 trillion³, which means the national debt grew 241.9 percent during this 10 year time period or 8.4 percent annually compounded. That being said, the national debt growth rate has receded significantly over the past three years, falling to an annual growth rate of 4.5 percent.

To put this into perspective, the national gross domestic product (GDP) through the third quarter 2014 was

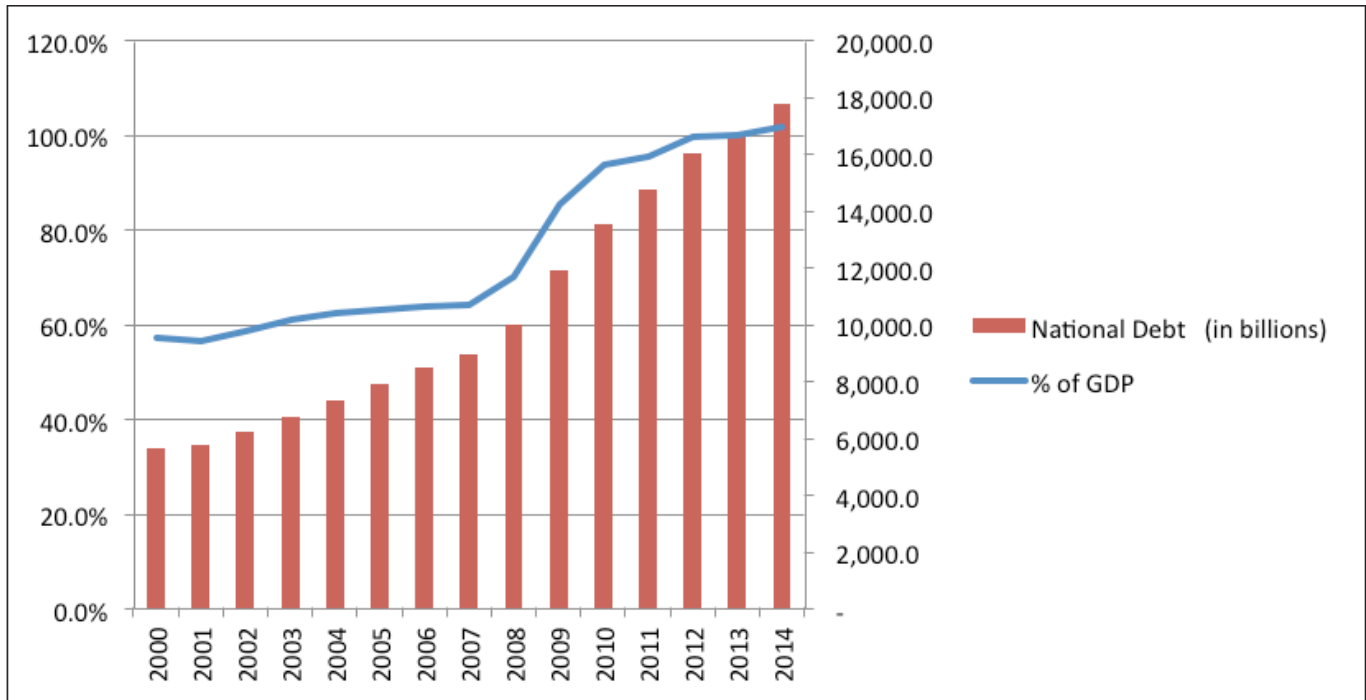
approximately \$17.5 trillion⁴, up from \$12.3 trillion in 2004. At the end of 2011, the last time this paper was updated, the national debt level was 95.3 percent of GDP. Economists believe that a sustainable economy exists at a maximum level of approximately 80 percent. Today, the U.S. national debt is 101.8 percent of the GDP⁵.

The significance of these two numbers lies within the contrast. The national debt is the amount that needs to be repaid; this can be thought of as the government's credit balance. Gross domestic product (GDP) represents the market value of all final goods and services produced within a country during a given period. Essentially, GDP represents the gross taxable income available to the government. If debts are increasing at a rate greater than the gross income available for taxation, then the only way to make up the difference is to increase the rate at which the gross income is being taxed.



6. Charts developed from data obtained through the Congressional Budget Office historical budget data

1. Congressional Budget Office projected deficit baseline 2014 - 2024
2. CBO, An Update to the Budget and Economic Outlook: 2014 - 2024
3. US Department of the Treasury's Bureau of the Fiscal Service, www.treasurydirect.gov/NP/debt/current
4. US Department of Commerce's Bureau of Economic Analysis, National Income and Product Accounts Tables
5. Federal Reserve Bank of St Louis Economic Research



As previously reviewed, and as the most recent analysis by the Congressional Budget Office (CBO) shows, the growth rate in the deficit has recently declined significantly and is projected to continue to decline through 2015 before once again beginning to increase at an unprecedented rate. However, the CBO report, along with the 2015 Presidential Budget both show a continuing trend in disparity between the growth in national debt and GDP over the next decade. The irresponsible behavior of borrowing more money than you make on a continuous basis is a disaster of epic proportions lying in wait.

Table S-1. Budget Totals
(In billions of dollars and as a percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Totals		
													2015-2019	2015-2024	
Budget Totals in Billions of Dollars:															
Receipts	2,775	3,002	3,337	3,568	3,811	4,030	4,226	4,452	4,706	4,954	5,212	5,478	18,972	43,775	
Outlays	3,455	3,651	3,901	4,099	4,269	4,443	4,729	4,964	5,209	5,485	5,694	5,912	21,441	48,705	
Deficit	680	649	564	531	458	413	503	512	504	530	482	434	2,468	4,930	
Debt held by the public	11,983	12,903	13,592	14,257	14,843	15,370	15,982	16,603	17,213	17,850	18,441	18,986			
Debt net of financial assets	10,926	11,575	12,138	12,669	13,127	13,540	14,043	14,555	15,058	15,588	16,070	16,503			
Gross domestic product (GDP)	16,619	17,332	18,219	19,181	20,199	21,216	22,196	23,200	24,225	25,280	26,381	27,531			
Budget Totals as a Percent of GDP:															
Receipts	16.7%	17.3%	18.3%	18.6%	18.9%	19.0%	19.0%	19.2%	19.4%	19.6%	19.8%	19.9%	18.8%	19.2%	
Outlays	20.8%	21.1%	21.4%	21.4%	21.1%	20.9%	21.3%	21.4%	21.5%	21.7%	21.6%	21.5%	21.2%	21.4%	
Deficit	4.1%	3.7%	3.1%	2.8%	2.3%	1.9%	2.3%	2.2%	2.1%	2.1%	1.8%	1.6%	2.5%	2.2%	
Debt held by the public	72.1%	74.4%	74.6%	74.3%	73.5%	72.4%	72.0%	71.6%	71.1%	70.6%	69.9%	69.0%			
Debt net of financial assets	65.7%	66.8%	66.6%	66.1%	65.0%	63.8%	63.3%	62.7%	62.2%	61.7%	60.9%	59.9%			

THE BUDGET FOR FISCAL YEAR 2015

Although the increasing disparity in growth rates between debt and GDP is a real concern and shows that, at least in the short run, the federal deficit will not be addressed to counteract the apparently inevitable crisis ahead, it is the revenue collection that tells the story that is most disconcerting. Over the past 40 years, the average collection of GDP for revenue has been approximately 17.3 percent, which is approximately where collections lie today.

To offer some perspective on the collection rate, the last time this report was updated collections were at 14.4 percent.

Since this point, we have seen several different tax increases, and we have begun seeing the effects of the recent ROTH conversion limitation removals, which helps explain the increase in collections.

As the presidential budget reveals, the projected revenues are estimated to be approximately 19.2 percent by the end of the next decade. That is an 11 percent increase in the revenue rate which, when related to the current tax rates, would put someone currently in the 39.6 percent tax bracket into a 44 percent tax bracket. The reality of this projected increase means that additional tax increases are on the horizon, and it would appear that this is going to be a graduated process beginning in 2015. This should tell us that as the debt ceiling discussions begin, they will be accompanied by a plan to implement additional tax increases over a period of three to five years.

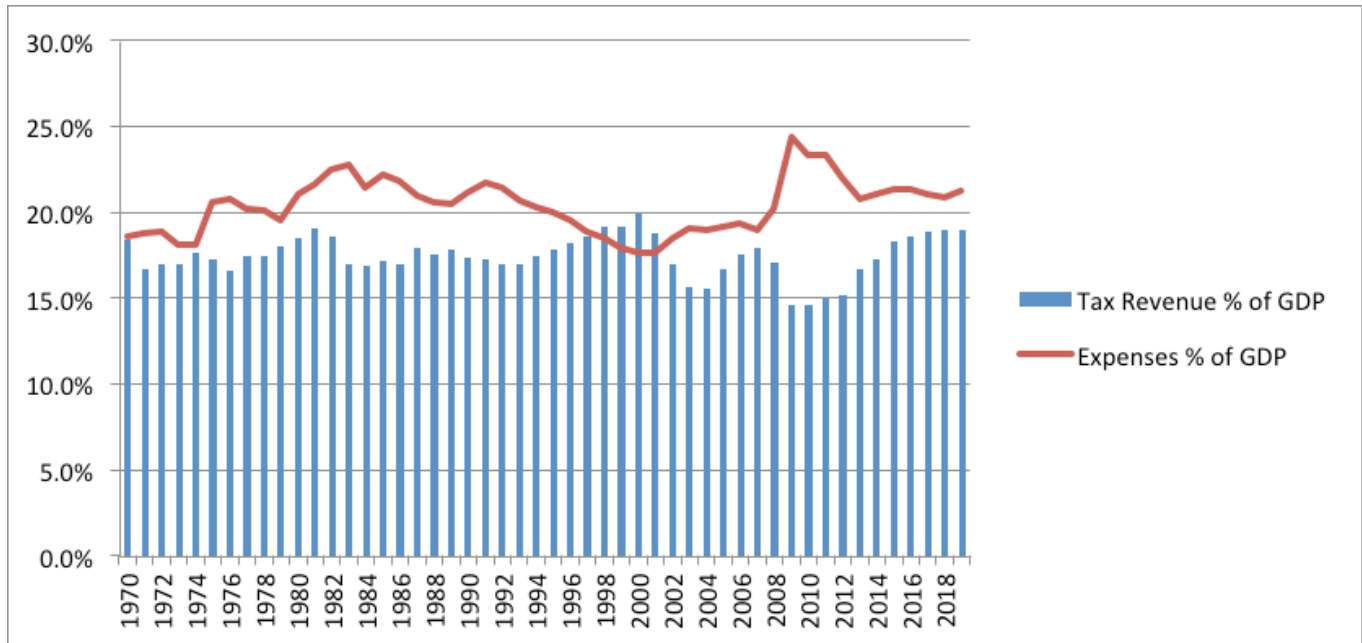
Unfortunately, the budget also shows that regardless of revenue collection rates and increased taxes, the deficit is

going to continue to increase. Sadly, without additional spending cuts to bring the budget into balance, we will continue to see tax increases over the coming years beyond this budget.

The End of an Era

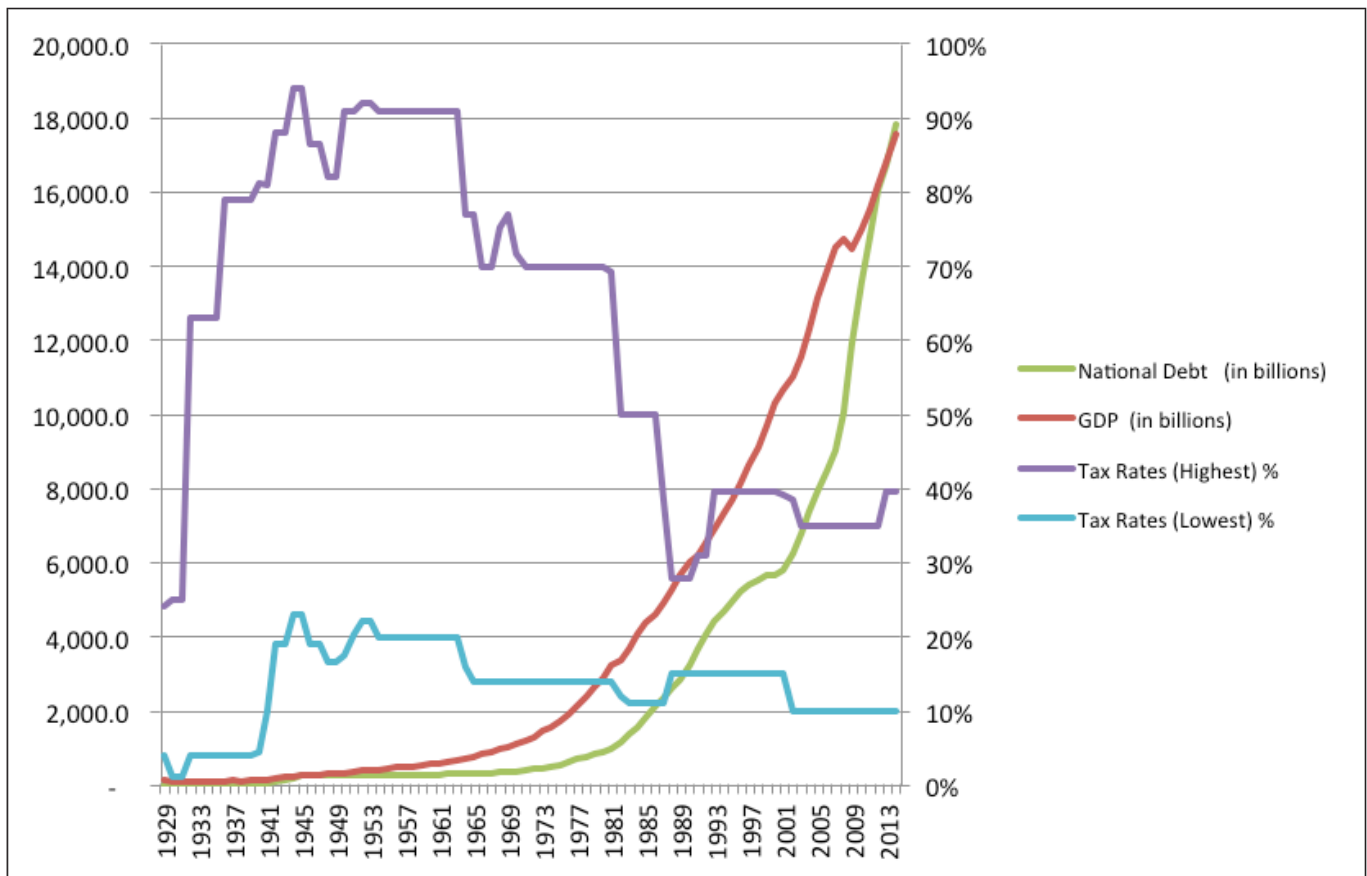
From a historical point of view, taxes are extremely low. The last time the U.S. national debt was even close to the same percentage level of GDP as it is today was at the end of World War II and for several years following. The maximum tax rate at that point, and through the years from 1944 through 1963, averaged 90 percent. Compare that to the maximum rate of 39.6 percent today, and it becomes very clear that there is a disparity of extreme proportion.

Taxes during this historical period were at extreme levels for nearly 20 years, during and following this level of debt-to-GDP. A significant point to note about the difference at that time versus where we are today is the economic activity.



The period of 1944 through 1963 was in the heart of both the Industrial Revolution and the birth of the baby-boom generation. Today, we are mired in extreme volatility with frequent periods of boom and bust accompanied by the beginning of the greatest retirement wave ever experienced within the U.S. economy.

To contrast these two time periods in respect to the recovery period is almost asinine as the external pressures from globalization and domestic unfunded liabilities did not exist or were irrelevant factors during the prior period.



To add insult to injury, U.S. domestic unfunded liabilities were estimated to be about \$84 trillion in 2012 and that number has only increased through the intervening years⁷. These liabilities exist outside of the annual budgetary debt discussed above and are due to items such as Social Security, Medicare and government pensions. The most concerning part of this goes back to the previous discussion of being on the cusp of the greatest retirement wave in U.S. history as the baby-boom generation begins retiring and expiring the unfunded Social Security for which they currently have entitlement. Over the long-run, expenditures related to healthcare programs such as Medicare and Medicaid are projected to grow faster than the economy overall as the

population matures.

To put unfunded liabilities into perspective, consider these as off-balance-sheet obligations similar to those of Enron. Although these are not listed as part of the national debt, they must be paid just the same. The difference between Enron and the U.S. unfunded liabilities is that if the U.S. government cannot come up with the funds to pay all these liabilities through revenue generation then they will print the money necessary to pay the debt.

What does the solution look like?

7. National Center for Policy Analysis, How Much Does the Federal Government Owe?, June 2012

Unfortunately, the general public is in a no-win situation for this solution to the problem. Printing money does not bode well for economic growth as this action creates inflationary pressures that devalue the U.S. dollar and make everyone less wealthy. Cutting the entitlements that compose this liability leaves millions of people without benefits they have come to expect. The only other option, and one that the government knows all too well, is increased taxes. In fact, according to a Congressional Budget Office paper issued in 2004⁸, unfunded liabilities are addressed as follows:

“The term ‘unfunded liability’ has been used to refer to a gap between the government’s projected financial commitment under a particular program and the revenues that are expected to be available to fund that commitment. But no government obligation can be truly considered ‘unfunded’ because of the U.S. government’s sovereign power to tax – which is the ultimate resource to meet its obligations.”

A balanced budget is going to be required at some point and with this will come higher taxes. Given our current position and projected budgets I think it is safe to say that tax increases are coming in the near future. And, as we continue to aspire in insanity by doing the same things over and over while expecting different results, we will find that raising taxes is a strategy to raise money, but it is not a solution to our current and pending problems.

How do you prepare?

Why do I want to spend so much time reassuring you that taxes will increase? Because you have an opportunity to take action. Now is the time to prepare for what is to come and structure countermeasures for the good, the bad and the ugly of each of these legislative nightmares through tax-free retirement planning.

I love to use the phrase; you make more money by saving on taxes than you do by making more money. The simplistic logic in the statement really makes sense when you discover it takes a \$1.50 in earnings to put that same dollar saved in taxes back into your pocket⁹. This simple concept becomes extremely valuable to people in retirement and those living on fixed incomes.

As simple as it sounds, it is much more difficult to execute. Most people fail to put together a plan as they near retirement, beginning with a simple cash flow

budget. If we have not analyzed our proposed income streams and expenses, we could not possibly have taken the time to position these cash flows and other events into a tax-preferred plan.

Most people will state, “I have a plan” and thus, they do not need any further assistance in this area. The truth in most instances is that people could not show you their plan, and of the few that could, they would not be able to show you how they have executed it. In this regard, they may as well be Richard Nixon stating, “I am not a crook” for as much as they state, “I have a plan.” The truth lies in waiting.

As we approach or begin retirement, we should be looking at what cash flows we will have. Do we have a pension? How about Social Security? How much additional cash flow am I going to need to draw from my assets to maintain the lifestyle that I desire?

We spend our whole lives saving and accumulating wealth but very little time determining how to distribute this accumulation to keep it. We need to make sure we have the appropriate diversification of taxable versus non-taxable assets to complement our distribution strategy.

The Benefits of Diversification

Heading into retirement, we should be situated with a diversified tax landscape. The point to spending our whole lives accumulating wealth is not to see how big the number is on paper, but rather, it should be an exercise in how much we put in our pocket after removing it from the paper.

To truly understand tax diversification, we must understand what types of money exist and how each of these will be treated during accumulation and, most importantly, during distribution. The following is a brief summary of our money:

1. Free money
2. Tax-free money
3. Tax-deferred money
4. Taxable money
 - a. Ordinary income
 - b. Capital gains and qualified dividends

8. CBO paper, Measures of the U.S. Government’s Fiscal Position Under Current Law, Sept. 2004

9. Assuming a 33 percent effective tax rate

Free Money

Free money is the best kind of money regardless of the tax treatment, because in the end you have more money than you would have otherwise. Many employers will provide contributions toward employee retirement accounts to offer additional employment benefits and inspire employees to save for their own retirement. With this, employers often times will offer a matching contribution in which they will contribute up to a certain percentage of an employee's salary, generally three to five percent, to that employee's retirement account when the employee contributes to their retirement account as well. For example, if an employee earns \$50,000 annually and contributes three percent (\$1,500) to their retirement account annually, the employer will also contribute three percent (\$1,500) to the employee's account. That is \$1,500 in free money. Take all that you can get!

Tax-Free Money

Tax-free money is the next best thing to free money. Although you have to earn tax-free money you do not have to give part of it away to Uncle Sam. Tax-free money comes in three basic forms that you can utilize during your lifetime; four if prison inspires your future, but we are not going to discuss that option.

The most commonly known form of tax-free money is municipal bonds, which earn and pay interest that could be federally tax-free, state tax-free, or both state and federally tax-free. There are several caveats that should be discussed in regard to the notion of tax-free income from municipal bonds. First, you will notice that tax-free has several flavors from the state and federal perspective. This is because states will generally tax the interest earned on a municipal bond unless the bond is offered from an entity located within that state. This severely limits the availability of completely tax-free municipal bonds and constrains underlying risk and liquidity factors. Second, municipal bond interest gets added back into the equation for determining your modified adjusted gross income (MAGI) for Social Security and could push your income above the thresholds subjecting a portion of your Social Security income to taxation. In effect, if this interest subjects some other income to taxation, then this interest is truly being taxed. Last, municipal bond interest may be excluded from the regular federal tax system, but it is included for determining tax under

the alternative minimum tax (AMT) system. I will not go into details on what the alternative minimum tax system is here, but the one thing everyone should know about AMT is that it is bad. In its basic form, the AMT system is a separate tax system that applies if the tax computed under AMT exceeds the tax computed under the regular tax system, the difference between these two computations is the alternative minimum tax.

Tax-Free Money: Roth IRA

Roth accounts are probably the single greatest tax asset that has come from Congress outside of life insurance and are well known of, but rarely used. Roth IRAs were first established by the Taxpayer Relief Act of 1997 and named after Senator William Roth, the chief sponsor of the legislation. Roth accounts are simply a retirement account that can be in the form of an individual retirement account or an employer sponsored retirement account that allow for tax-free growth of earnings and tax-free income.

The main difference between a Roth and a traditional IRA or employer sponsored plan lies within the timing of the taxation. We are all very familiar with the typical scenario of putting money away for retirement through an employer plan, whereby they deduct money from our paychecks and put it directly into a retirement account. This money is taken out before taxes are calculated so we do not pay tax on those earnings today. A Roth account on the other hand takes the money after the taxes have been taken out and then puts it into the retirement account, so we do pay tax on the money today. The other significant difference between these two is taxation during distribution in later years. With our traditional retirement accounts when we take the money out later it gets added to our ordinary income and gets taxed accordingly. Additionally, by including this in our income it subjects us to such things mentioned above for municipal bonds with Social Security taxation, AMT, as well as higher Medicare premiums. A Roth on the other hand gets distributed tax-free and does not contribute toward negative impact items such as Social Security taxation, AMT, or Medicare premium increases. It essentially comes back to us without tax and other obligations.

The best way to view the difference between the two accounts is to look at the life of a farmer. A farmer will

buy seed, plant it in the ground, grow the crops, and harvest it later for sale. Typically, the farmer would only pay tax on the crops that have been harvested and sold. Let me ask the question however, if you were the farmer, would you rather pay tax on \$5,000 worth of seed that you plant today or \$50,000 worth of harvested crop later? The obvious answer is \$5,000 worth of seed today. The truth to the matter is that you are a farmer, only you plant dollars into your retirement account instead of seeds into the earth.

So why doesn't everyone have a Roth retirement account if things are so simple? There are several reasons, but the single greatest reason has been the constraints on contributions. If you earned over certain thresholds (MAGI over \$129,000 single and \$191,000 joint for 2014), you were not eligible to make contributions. Until 2010, if your modified adjusted gross income (MAGI) was over \$100,000 (single or joint), then you could not convert a traditional to a Roth. Outside of these contribution limits, most people save for retirement through their employers and most employers are not offering Roth options within their plans. The reason behind this is because Roth accounts are not that well understood and people have been educated to believe that saving on taxes today is the best possible course of action.

Tax-Free Money: Life Insurance

As I previously mentioned, the single greatest tax asset that has come from Congress outside of life insurance is the Roth account. Life insurance is the little known or discussed tax asset that holds some of the greatest value for our financial lives both during life and upon death and is by far the best tax-free device available. We traditionally view life insurance as a way to protect our loved ones from financial ruin upon our demise, and it should be noted that everyone who cares about someone should have life insurance. By purchasing a life insurance policy, our loved ones will be assured a financial windfall from the life insurance company when we die to help them with our final expenses and carry on their lives without us comfortably. The best part about the life insurance windfall is the fact that nobody will have to pay tax on the money received. This is the single greatest tax-free device available, but it has one downside, we do not get to use it ... only our heirs will.

The little known and discussed part of life insurance is the cash value build-up within whole life and universal life (permanent) policies. Life insurance is not typically

seen as an investment vehicle for building wealth and retirement planning, although we should discuss briefly why this thought process should be re-evaluated. Permanent life insurance is generally misconceived as something that is very expensive for a wealth accumulation vehicle as there are mortality charges (fees for the death benefit) that detract from the returns that are available and further, those returns do not yield as much as the stock market over the long run. This is why many times you will hear the phrase "buy term and invest the rest," where "term" refers to term insurance. Let us take a second to review two terms just used in regard to life insurance: term and permanent.

Term insurance is what most people are familiar with, you purchase a certain death benefit that will go to your heirs upon your death, and this policy will be in effect for a certain number of years, typically 10 to 20 years. The 10 to 20 years is the term of the policy. Once we have reached that end, we no longer have insurance unless we purchase another policy at that point.

Permanent insurance on the other hand has no term involved. It is permanent as long as the premiums continue to be paid. Permanent insurance generally has higher premiums than term insurance for the same amount of death benefit coverage, and it is this difference that is referred to when people say "invest the rest."

Simply speaking, there are significant differences between these two policies that do not get taken into consideration when providing a comparative analysis in the numbers. One item that gets lost in the fray when comparing term and permanent insurance is that term usually expires before death, in fact insurance studies show less than 1 percent of all term policies pay out death benefit claims. The issue arises when the term expires and the desire to have more insurance is still present. A term policy with the same benefit will be much more expensive than the original policy. Many times life events occur with illness such as cancer or heart conditions that make it impossible to acquire another policy, leaving our loved ones unprotected and tax-free legacy planning is out of the equation.

Another aspect and probably the most important piece in consideration of the future of taxation is the fact that permanent insurance has a cash accumulation value. Two aspects stand out with the cash accumulation value. First, as the cash accumulation value increases the death

benefit will also increase where term insurance is level. Second, this cash accumulation offers value to you during your lifetime rather than just your heirs upon death. The cash accumulation value can be used for tax-free income during your lifetime through policy loans. Most importantly, this tax-free income is available during retirement for distribution planning, all while offering the same typical financial protection to your heirs.

Tax-Deferred Money

Tax-deferred money is the type of money from which most of us are familiar and has been reviewed briefly already. So, I will not spend much time reviewing them here. Tax-deferred money is typically our traditional IRA, employer sponsored retirement plan, or a non-qualified annuity. Essentially, we put money into an investment vehicle that will accumulate in value over time, and we do not pay taxes on the earnings that grow these accounts until we distribute them. Once the money is distributed, taxes must be paid. In addition to the taxes, the same negative consequences exist toward

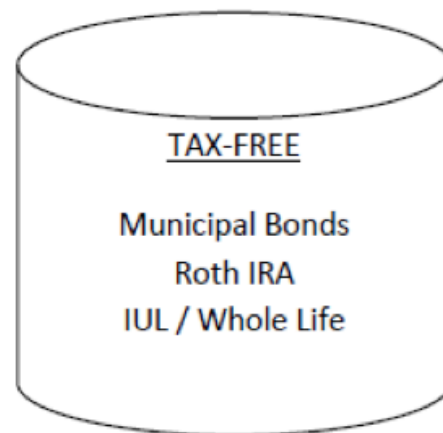
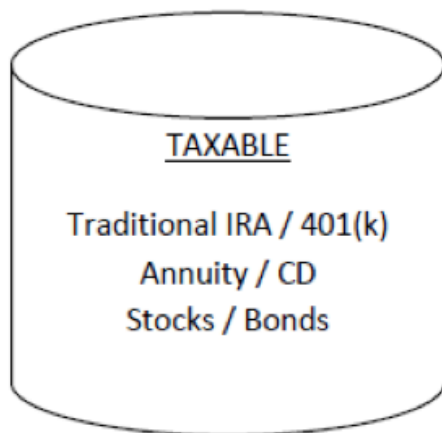
additional taxation and expense in other areas as previously discussed.

Taxable Money

Taxable money is everything else and is taxable both today and later, whenever it is received.

Of these four types of money, they really come down to two distinct classifications; taxable and tax-free.

The greatest difference in discussing comparison between taxable and tax-free income is a function of how much money we keep after tax. For help in determining what the differences should be, exclusive of outside factors such as Social Security taxation and AMT, a tax equivalent yield should be used. Below is a taxable equivalent yield table that will show how much taxable earning will be needed to break-even with a tax-free yield given your incremental tax bracket.



Tax-Free in the Real World

To put the tax equivalent yield into perspective, let us look at an example:

Bob and Mary are currently retired and in the 25 percent tax bracket living on Social Security and interest from investments. They have a substantial portion of their investments in municipal bonds yielding 6.0 percent, which in today's market is quite comforting. The tax equivalent yield they would need to earn from a taxable investment would be 8.0 percent, a 2.0 percent gap which seems almost impossible given current market volatility. However, something that has never been put into perspective is that the interest from their municipal bonds is subject to taxation on their Social Security benefits¹⁰ (at 21.25 percent). With this, the yield on their municipal bonds would be 4.725 percent¹¹, and the taxable equivalent yield falls to 6.3 percent leaving a gap of only 1.575 percent.

In the end, most of us spend our lives accumulating wealth through the best, if not only, vehicle we know, a tax-deferred account. This account is most likely a 401(k) or 403(b) plan offered through our employer and may be supplemented

Taxable Equivalent Yield Table					
	Federal Marginal Tax Bracket				
	15 percent	25 percent	28 percent	33 percent	35 percent
Tax-Free Yield	A Taxable Investment Must Have This Yield or Higher				
4 percent	4.7 percent	5.3 percent	5.6 percent	6.0 percent	6.2 percent
5 percent	5.9 percent	6.7 percent	6.9 percent	7.5 percent	7.7 percent
6 percent	7.1 percent	8.0 percent	8.3 percent	9.0 percent	9.2 percent
7 percent	8.2 percent	9.3 percent	9.7 percent	10.4 percent	10.8 percent
8 percent	9.4 percent	10.7 percent	11.1 percent	11.9 percent	12.3 percent

with an IRA that was established at one point or another. As the years go by, we blindly throw money into these accounts in an effort to save for a retirement that we someday hope to reach.

The truth is we all have an age selected for when we would like to retire but spend our lives wondering if we will ever be able to actually quit working. To answer this question, we must understand how much money we will have available to contribute toward our needs. In other words, we need to know what our after-tax income will be during this period.

All else being equal, it would not matter if you put your money into a taxable, tax-deferred, or tax-free account as long as income tax rates never change and outside

factors are never an event. The net amount you receive in the end will be the same. Unfortunately, none of this will ever be the circumstance. We already know that taxes will increase in the future with the likely forecast of being higher in retirement than during our peak earning years.

Regardless, saving for retirement in any form is a good thing since it appears from all practical perspectives that future government benefits will be cut and taxes will increase. We have the ability to plan today for efficient tax diversification and maximization of our after-tax dollars during our distribution years. Don't let your opportunity become Uncle Sam's retirement.

10. Assuming each dollar of interest subjects a dollar of Social Security income to taxation at 85 percent

11. 6.0 percent - (6.0 percent * 21.25 percent) = 4.725 percent

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