washingtonpost.com

Dividend Voodoo

By Warren Buffett

Tuesday, May 20, 2003; Page A19

The annual Forbes 400 lists prove that -- with occasional blips -- the rich do indeed get richer. Nonetheless, the Senate voted last week to supply major aid to the rich in their pursuit of even greater wealth.

The Senate decided that the dividends an individual receives should be 50 percent free of tax in 2003, 100 percent tax-free in 2004 through 2006 and then again fully taxable in 2007. The mental flexibility the Senate demonstrated in crafting these zigzags is breathtaking. What it has put in motion, though, is clear: If enacted, these changes would further tilt the tax scales toward the rich.

Let me, as a member of that non-endangered species, give you an example of how the scales are currently balanced. The taxes I pay to the federal government, including the payroll tax that is paid for me by my employer, Berkshire Hathaway, are roughly the same proportion of my income -- about 30 percent -- as that paid by the receptionist in our office. My case is not atypical -- my earnings, like those of many rich people, are a mix of capital gains and ordinary income -- nor is it affected by tax shelters (I've never used any). As it works out, I pay a somewhat higher rate for my combination of salary, investment and capital gain income than our receptionist does. But she pays a far higher portion of her income in payroll taxes than I do.

She's not complaining: Both of us know we were lucky to be born in America. But I was luckier in that I came wired at birth with a talent for capital allocation -- a valuable ability to have had in this country during the past half-century. Credit America for most of this value, not me. If the receptionist and I had both been born in, say, Bangladesh, the story would have been far different. There, the market value of our respective talents would not have varied greatly.

Now the Senate says that dividends should be tax-free to recipients. Suppose this measure goes through and the directors of Berkshire Hathaway (which does not now pay a dividend) therefore decide to pay $1 billion in dividends next year. Owning 31 percent of Berkshire, I would receive $310 million in additional income, owe not another dime in federal tax, and see my tax rate plunge to 3 percent.

And our receptionist? She'd still be paying about 30 percent, which means she would be contributing about 10 times the proportion of her income that I would to such government pursuits as fighting terrorism, waging wars and supporting the elderly. Let me repeat the point: Her overall federal tax rate would be *10 times* what my rate would be.

When I was young, President Kennedy asked Americans to "pay any price, bear any burden" for our country. Against that challenge, the 3 percent overall federal tax rate I would pay -- if a Berkshire dividend were to be tax-free -- seems a bit light.

Administration officials say that the $310 million suddenly added to my wallet would stimulate the economy because I would invest it and thereby create jobs. But they conveniently forget that if Berkshire kept the money, *it* would invest that same amount, creating jobs as well.

The Senate's plan invites corporations -- indeed, virtually commands them -- to contort their behavior in a major way. Were the plan to be enacted, shareholders would logically respond by asking the corporations they own to pay no more dividends in 2003, when they would be partially taxed, but instead to pay the skipped amounts in 2004, when they'd be tax-free. Similarly, in 2006, the last year of the plan, companies should pay double their normal dividend and then avoid dividends altogether in 2007.

Overall, it's hard to conceive of anything sillier than the schedule the Senate has laid out. Indeed, the first President Bush had a name for such activities: "voodoo economics." The manipulation of enactment and sunset dates of tax changes is Enron-style accounting, and a Congress that has recently demanded honest corporate numbers should now look hard at its own practices.

Proponents of cutting tax rates on dividends argue that the move will stimulate the economy. A large amount of stimulus, of course, should already be on the way from the huge and growing deficit the government is now running. I have no strong views on whether more action on this front is warranted. But if it is, don't cut the taxes of people with huge portfolios of stocks held directly. (Small investors owning stock held through 401(k)s are already tax-favored.) Instead, give reductions to those who both need and will spend the money gained. Enact a Social Security tax "holiday" or give a flat-sum rebate to people with low incomes. Putting $1,000 in the pockets of 310,000 families with urgent needs is going to provide far more stimulus to the economy than putting the same $310 million in my pockets.

When you listen to tax-cut rhetoric, remember that giving one class of taxpayer a "break" requires -- now or down the line -- that an equivalent burden be imposed on other parties. In other words, if I get a break, someone else pays. Government can't deliver a free lunch to the country as a whole. It can, however, determine who pays for lunch. And last week the Senate handed the bill to the wrong party.

Supporters of making dividends tax-free like to paint critics as promoters of class warfare. The fact is, however, that their proposal promotes class *welfare.* For my class.

The writer is chief executive officer of Berkshire Hathaway Inc., a diversified holding company, and a director of The Washington Post Co., which has an investment in Berkshire Hathaway.