# THE HISTORY OF TAXES VS DEBT

The focus on tax reform over the next weeks and months will be turbulent. Your clients are hearing bites from both sides, and many will become paralyzed or stuck because of all the noise and uncertainty that surrounds tax legislation. We want to look at history relative to taxes and debt to help you help your clients understand where we are at, where we might go, and how it will affect them personally.

Estate taxes as we know them today were enacted in 1916. Prior to that, Congress enacted an estate tax three times to raise monies to fund war efforts. The first was in 1797 for an undeclared war against France, 1862 for the Civil War and 1898 for the Spanish American war. In all 3 occasions, when the wars ended Congress repealed the estate tax.

Fast forward to 1916 and the US manufacturing sector was booming, and wealth was being concentrated by a handful of individuals. Progressives were not happy with this inequity of wealth, and the 16th Amendment was ratified, adding a federal income tax to law. In 1917 the US entered WWI and Congress enacted an estate tax. When the war ended, they did not repeal the estate tax, and it remains today.

Where are our current tax rates relative to history? You can see that we are in relatively low tax rate environment.

| Date | Top Individual Income Tax Rate % | Top Individual Estate Tax Rate % | Top Corporate Income Tax Rate % |
|---|---|---|---|
| 1/1/1920 | 73 | 25 | 10 |
| 1/1/1930 | 25 | 20 | 12 |
| 1/1/1940 | 81 | 70 | 40 |
| 1/1/1945 | 94 | 77 | 40 |
| 1/1/1950 | 84 | 77 | 42 |
| 1/1/1955 | 91 | 77 | 52 |
| 1/1/1960 | 91 | 77 | 52 |
| 1/1/1965 | 70 | 77 | 48 |
| 1/1/1970 | 72 | 77 | 49 |
| 1/1/1975 | 70 | 77 | 48 |
| 1/1/1980 | 70 | 70 | 46 |
| 1/1/1985 | 50 | 55 | 46 |
| 1/1/1990 | 28 | 55 | 34 |
| 1/1/1995 | 40 | 55 | 35 |
| 1/1/2000 | 40 | 55 | 35 |
| 1/1/2005 | 35 | 47 | 35 |
| 1/1/2010 | 35 | 0 | 35 |
| 1/1/2015 | 40 | 40 | 35 |
| 1/1/2020 | 37 | 40 | 21 |
| 1/1/2024 | 37 | 40 | 21 |

Now let's factor the country's debt into this conversation. The current US debt is over $36 trillion, which as a percentage of GDP exceeds 120%. The chart below shows historical US debt levels expressed as a percentage of that year's GDP.

| Date | Total US Debt as a % of GDP |
|---|---|
| 1/1/1920 | 33 |
| 1/1/1930 | 15 |
| 1/1/1940 | 43 |
| 1/1/1945 | 113 |
| 1/1/1950 | 86 |
| 1/1/1955 | 54 |
| 1/1/1960 | 44 |
| 1/1/1965 | 40 |
| 1/1/1970 | 36 |
| 1/1/1975 | 33 |
| 1/1/1980 | 31 |
| 1/1/1985 | 44 |
| 1/1/1990 | 56 |
| 1/1/1995 | 64 |
| 1/1/2000 | 54 |
| 1/1/2005 | 61 |
| 1/1/2010 | 92 |
| 1/1/2015 | 103 |
| 1/1/2020 | 126 |
| 1/1/2024 | 120 |

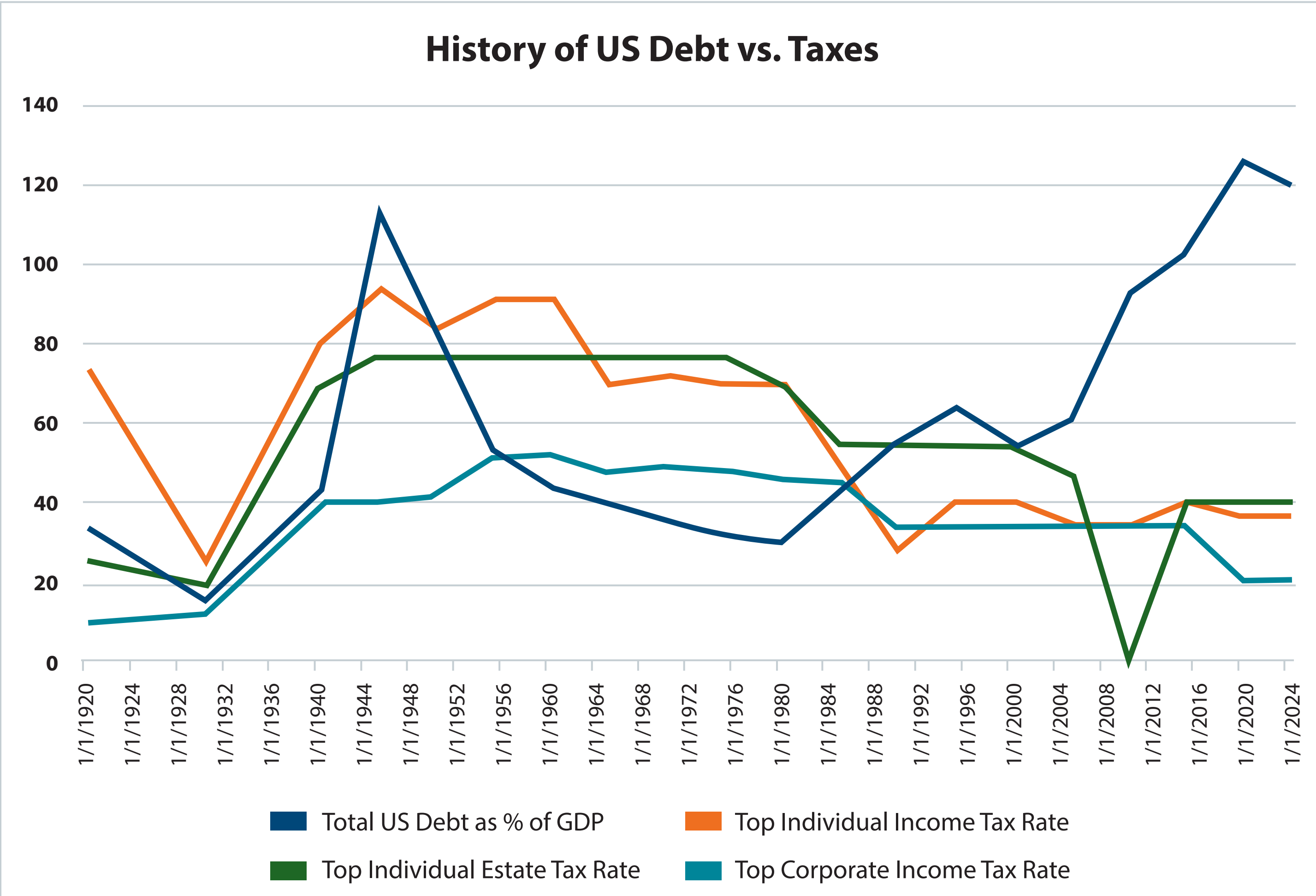
World War II is an interesting parallel to the deficit incurred since Covid. In 1945 the percentage of US debt to GDP was 113%. Two decades later, in 1965 it had been reduced to 40% from 113%.

This deficit reduction was accomplished in part by high taxation. Look at the tax rates from 1945 to 1965. They were significantly higher than today: 91% for individual income, 52% for corporate income, and 77% for estate tax.

While we don't think that tax rates will revert to 91% for individuals, but we do feel it is important for your clients to realize the reality of the tax and debt conditions today.

***Our tax rates are historically low, and debt levels are historically high.***

The graph below shows the history of US Debt compared to income and estate taxes. You can see clearly that starting in 2008, the debt has soared and taxes have not kept up as in the prior years.




If your clients can understand this graph, a logical course of action would be **to go on the offense and protect one's assets from future taxation**. Protect against income taxation by using overfunded cash value life insurance in and out of the estate to protect growth on assets earmarked for accumulation, especially for younger generations. Protect against estate taxation by fully utilizing the current lifetime estate and gift exemption, and using GRATs or sales to grantor trusts to further remove growth of assets outside of one's estates. Protect retirement funds from excessive income and estate taxation by leveraging qualified funds with an IRA max strategy.

Had the results of the election been different, the Democratic tax proposals floating around prior to the election would have had a strong probability of being passed. They reduced the lifetime gift exemption to $3 million, raised estate taxes to 70%, taxed unrealized capital gains, and rendered GRATS, grantor trusts and discounts basically useless as effective estate planning tools. Even if the Trump administration is able to keep taxes where they are, or even reduced, how long can it be sustained?

Over the past two decades, clients have not felt the urgency to play offense when confronting taxes because our tax conditions have been favorable. ***If history repeats itself and numbers don't lie, it is a reasonable conclusion to expect that taxes must increase***.

We will be keeping a close eye on tax legislation and will keep you informed, and hope this will help you set the stage for planning opportunities with your clients as it unfolds.

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