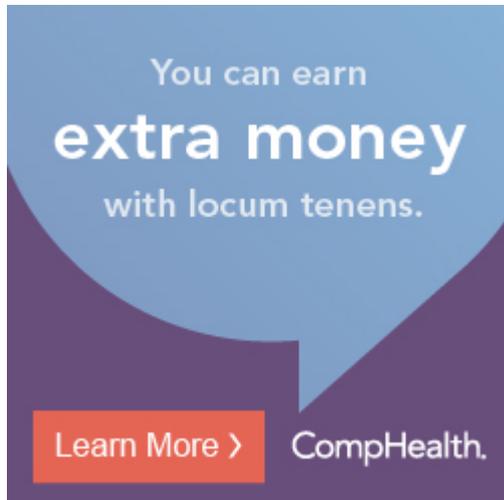


It's Not Just Our Tax System That Is Progressive



This post is another one of those rants about first world problems, and I'm sure I'll get lots of hate comments and email about it. But I'm going to discuss a concept that I think needs to be brought out into the open. Our federal income tax system is progressive, meaning that those who have more income not only pay more, but actually pay a higher percentage of that income. The tax brackets themselves are progressive, but when you add in the effects of the phaseouts of various credits and deductions, the system is far more progressive than you might at first imagine. However, our tax system is far from the only financial system in our lives that is progressive. Before we get into the details, let's talk about a couple of caveats on the topic.

I'm Not Talking About Benefits For the Poor

The government provides a safety net for all of us. The very poor are entitled to benefits such as food stamps, housing assistance, and Medicaid. While those benefits are clearly progressive, that's not really what I'm talking about in this post. What I'm talking about is financial progressiveness throughout the range of income.

Charity Goes Both Ways

In some ways, contributions to charity are progressive, but in other ways are actually regressive. For example, consider someone who gives a set percentage of income to a charity, such as a Christian who pays tithing. If he pays 10% of his gross pay, that's actually a higher percentage of his net pay than a lower earner. But even if he is paying on his net pay, that's still more money, even if it is the same percentage. But once you apply the effect of the phaseout on itemized deductions, charitable contributions become even more progressive.

However, they are also regressive in certain ways. For example, if you're in the 33% bracket and give \$1000 to charity, it really only costs you \$670. If you're in the 15% bracket, that will cost you \$850. In addition, low earners may not be able to deduct charitable contributions at all, since the total of their itemized deductions is less than the standard deduction, or perhaps only a small amount more. So we'll call charity a wash. Now, let's get into 7 topics that are anything but a wash.

Social Security Benefits

The Social Security system is very interesting when you really examine it. It functions both as a safety net and as a retirement savings plan. That was probably necessary to get the votes to pass it in the first place. But the effect of that combination results in a fairly progressive system. If you are a low earner, comparing your Social Security contributions to your eventual benefits shows those contributions to be an excellent investment. If you're making larger contributions, your benefit does go up, but not by nearly as much. If a doctor calculates out his rate of return on his Social Security contributions, it will make the investment performance of a whole life policy look pretty good

by comparison. To make matters worse, higher earners pay more tax on their Social Security benefits, making the system even more progressive.

Health Care Costs

There are several ways in which your health care costs are progressive. Not only are Medicare taxes higher for higher earners (thanks to the special Obamacare taxes) but your Medicare premiums are also means-tested if you make more than \$85,000 (\$170,000 married.) Even Medicare Part D (the prescription drug benefit) is means-tested. However, that is relatively small compared to the effects of the Obamacare Subsidy. This subsidy gradually decreases as you move from 138% of the poverty line to 400% of the poverty line. In my state, 400% of poverty line for a family of six is \$130,280. That's the 97% percentile as far as incomes go. So for basically everyone, health care is now priced quite progressively. Not to mention, of course, that while higher earners get more Social Security benefits for their higher SS tax burden, high earners pay higher Medicare taxes to get the same benefit as everyone else.

Higher Educational Costs

This is a big one. The difference between the sticker price and the actual price at many colleges, especially private colleges, in the country is highly dependent not just the student's income, but also the family's income. For example, at Amherst College (the most progressively priced in the nation, by the way) the highest income tier students have an actual cost of \$40,000. The lowest tier? Just \$2,000. At Stanford, tuition is free if your parents make less than \$125,000. If they make less than \$65,000, you get room and board too. If you're going to give it away free to 95% of people, why discriminate against the other 5%? Just make it free for everyone like Berea College. You certainly have the endowment to do it.

Taxes

Another big one, that most people are very familiar with, is the tax code. I mentioned earlier the effect of the progressive federal tax brackets as well as the phaseouts. But it gets even better. Many states have progressive income tax systems. In California, it starts at 1% and goes as high as 13.30%. The federal and many state estate tax systems are also generally quite progressive. For instance, at the federal level, the exemption is \$5.45 Million (\$10.9 Million married.) Above that, you're looking at brackets that start at 18% and rapidly climb to 40%. And don't forget the capital gains tax system. If you're in the 15% federal income tax bracket or below, your capital gains rate is 0%. If you're in the 25% to 35% brackets, you pay 15% on capital gains. If you're in the highest (39.6%) bracket, your capital gains rate is 20%. The Obamacare taxes are stacked on top of these. So if you make more than \$200,000 (\$250,000 married) you pay an extra 3.6% on your investment income and an additional 0.9% on your earned income.

Licensing Fees

How about your licensing fees? Most of you have heard about [Utah's Medicaid Expansion Plan](#) where the legislature wanted to increase the physician license fee to \$5,000. But even before looking at that outrageous idea, license fees were quite progressive. In Utah, a physician license, not including the DEA license and multi-state licensing agency fees (which total over \$1,000) is \$200. A dietitian? \$60. And don't think the price is lower because practicing medicine is more complex than being a dietitian. There are other people who practice medicine, PAs are \$180 and NPs/CRNAs are \$140. There is definitely a progressive component there above and beyond the costs of running the program.

The Doctor Price

If you've never been asked to pay a higher price "because you can afford it" either directly or indirectly, you're just not paying attention. It has gotten to the point where I'm ready to take the diploma off the wall when contractors come over. When people ask what I do for a living, I'm a blogger or a writer. Sounds like I make a lot less money, right? They don't need to know that I make about as much writing and blogging as practicing medicine. Guess what? It gets me cheaper prices.

Family Expectations

Many doctors, especially those who come from relatively poor backgrounds have experienced this. It isn't so much of a deal for us because we both come from middle class backgrounds and our siblings generally have pretty good incomes. But for many docs, there is an expectation that since you've "made it big" that you will be providing more cash support for parents, providing loans to siblings, or simply chipping in more for family functions. In some families, that support is quite explicit. I have had some doctors tell me about how their father demanded to see their W-2 so he could calculate how much he should get from it. In other families, the expectations are unsaid, but still remain. Family dynamics are different across cultures and even individual families within a culture, but much of the time there is a progressive nature to them.

What To Do About Progressive Financial Systems

When you add up all of these effects, it is easy to see why many physicians and other high income professionals don't really feel very rich. At first glance, progressiveness seems like a good idea- those who have more should pay more. But you have to be careful about unintended consequences. Imagine someone in California with marginal tax rates of 39.6% (federal), 3.8% (payroll), and 13.3% (state) who also pays 10% of his gross income to his church but is phased out of the deduction for it. He only gets to spend 1/3 of his next

dollar. I don't know about you, but I'm not willing to do a whole lot of extra work for 1/3 the pay, especially when I already have "enough." I'm much more likely to go canyoneering instead. Meanwhile, you get to see fewer blog posts and society has to wait longer to get emergency care. Unintended consequences. In a perfectly progressive system, there is no incentive to work at all. Luckily, even with all of these progressive financial systems in our society, it is still not perfectly progressive. But it is probably far more progressive than most people think.

So, now that you're aware of these systems, what can you do about them? As you can see, there are huge incentives to make less money. So if additional money isn't making you any happier, work less and make less. Not only will you pay less in taxes, but your kid's college education will be cheaper and your health care will be cheaper. You are also incentivized to get less of your income from work, and more from more passive activities. Even better if that income occurs in retirement accounts- since that doesn't show up on your tax return at all- so be sure to max those out. It will lower the effect of progressive tax systems this year and for years into the future.

Perhaps most importantly, you can learn the rules of the game. For example, if your kid is really interested in Stanford, perhaps it is time to go part-time this year instead of next. Or perhaps you'll liquidate your taxable account despite the taxes instead of withdrawing from an IRA, since taxable assets count more against you in the Expected Family Contribution calculation. Maybe you'll move from California to Nevada or Texas. Or take your diploma off the wall and not put that "School of Medicine" sticker on the back of the car. Or choose to give up your medical license at retirement rather than keep it in order to do some charitable medical work. Perhaps most importantly, you can decide to be happy with less, a la Mr.

Money Mustache. If you can be happy spending \$50K or even \$100K a year, you can avoid a lot of these effects and spend a heck of a lot less time in your life working for pay. By paying off your student loans and mortgage relatively early in your career, you can free yourself up to simply earn less and take advantage of these progressive systems without feeling deprived financially.



Another First World Problem-
Getting all that mud and
sand out of my wetsuit after
these trips

Now, of course all this is a “first world” problem, just like [“burnout” and “work-life balance.”](#) My detractors will surely accuse me of being a “rich whiner.” But who are we trying to kid? This entire website is filled with solutions to first world problems. That’s all I ever write about. Obviously, I prefer a higher income to a lower one, despite the additional costs. There is only so much I’m willing to do to reduce the progressiveness of my financial life. But it is good to be aware of this sort of thing because it should have an impact on the decisions you make about how much to work, how much to spend, and how much to save. Find the balance that is right for you.

What do you think? Are there any other areas in life where the price you pay is progressive? What changes have you made in your financial life as a result of the progressiveness of the

tax system, the health care system, the college system, or your family? Comment below!