

THE RACE FOR THE WHITE HOUSE

Are Bush's Tax Cuts Doing the Job?

The president argues that a Kerry rollback of high-bracket cuts would deter hiring, but many entrepreneurs and small businesses hire no one.

By Warren Vieth, Times Staff Writer

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WASHINGTON — In appearances across the country, President Bush contends that the tax proposals of Sen. John F. Kerry would shut down a powerful engine of employment growth in America.

Kerry's plan to roll back income tax reductions for the wealthy, the president says, would "raise taxes for the 900,000 small businesses and entrepreneurs ... who are creating most of the new jobs in our changing economy."

There's no question some of the wealthy tax filers whose taxes would go up if Kerry's plan were enacted are the kind of corner-store proprietors and growth-company entrepreneurs Bush likes to describe in his speeches. Some clearly have created lots of jobs.

But statistics show that only 1 in 25 small-business owners would be affected by Kerry's tax increases. Of those who would get hit, half have no employees other than themselves. They include lawyers, accountants, consultants and investors who fall within Bush's generous definition of small business.

"There is absolutely no direct connection between reducing my taxes and increasing employment," said Eric Schoenberg, a New Jersey investor who fits Bush's definition because he and his wife report income on a tax form used by some small businesses. Schoenberg receives a graduate fellowship stipend at Columbia University, and his wife receives architect fees. Neither has any employees.

"If anyone were to describe me as a small-business owner, they would definitely be stretching," Schoenberg said. "I wouldn't call myself an entrepreneur either."

The issue of small-business ownership and its effect on employment is important because it addresses the credibility of one of Bush's principal defenses of the four rounds of tax cuts he has pushed through Congress since taking office.

According to administration officials, small businesses create two out of three new jobs and employ half of all private-sector workers. About 90% of them are organized as proprietorships, partnerships and Subchapter S corporations whose profits and losses "flow through" to the personal tax returns of their owners, rather than being taxed as a separate corporate entity.

About 25 million small-business owners will benefit this year from the president's tax cuts, the administration said. Of those, officials said, 940,000 would see their taxes go back up under Kerry's proposal to rescind the Bush cuts for people in the top two income tax brackets — almost everyone with an annual income above \$200,000.

If Bush's characterization is accurate, the plan by his Democratic presidential rival could undermine the economy's slow rate of job creation by taking money out of the pockets of people who do much of the hiring. If it is exaggerated, the economic effect would be of less consequence, and the president's broader claims about his tax cuts less persuasive.

According to the nonpartisan Tax Policy Center, a joint venture of the Brookings Institution and the Urban Institute, no more than half of the taxpayers with flow-through business income whose taxes would rise under Kerry's plan are classic small-business operators who employ other people.

"It appears that fewer than 500,000 are in that category," said Len Burman, co-director of the center. "It's up to other people to decide whether that's a big number or a small number. But it's definitely far below 900,000."

Administration officials said they disagreed with the center's interpretation, arguing that top-bracket partnerships and Subchapter S corporations accounted for a disproportionately large share of small-business employment. But they declined to provide a statistical breakdown showing how many of these types of taxpayers had employees and how many employees were on their payrolls.

Raymond Arth, chairman of the National Small Business Assn., a Washington-based trade group, said he was convinced Kerry's tax plan would have a detrimental effect on job creation.

"It's not the image that Sen. Kerry is trying to project when he talks about these rich people in the top 1%," said Arth, president of Phoenix Products Inc., a 43-employee operation near Cleveland that makes water faucets for recreational vehicles. "These are folks that get up early, go to work every day, have gambled an awful lot and have to make a big income just to pay the bills they've incurred to make their businesses run."

Bob Roth is a case in point. Roth, 42, is president and one of eight shareholders of RoMan Manufacturing Inc. in Grand Rapids, Mich., a family-owned firm that makes transformers for industrial welding equipment and has about 100 employees.

RoMan, a Subchapter S corporation, has about \$30 million in annual revenues and about \$3 million in profits. Because Bush lowered the top individual income tax rate from 39.6% to 35%, the firm is able to retain more than \$100,000 that it otherwise would distribute to its owners to cover their tax payments, Roth said. This year, it used some of its earnings to buy three computer-aided machine tools.

"It's not like, 'Oh, wow, there's \$100,000 more inside the business because the tax rates are lower, let's go hire another person.' I'm not going to tell you it's that direct a correlation," Roth said. "But what I can tell you is it allows me to make better investments in our business, allows us to stay competitive and continue to grow our business.... Ultimately, that is going to increase employment at RoMan."

Not all wealthy taxpayers with business income buy the administration's claims about tax rates and job creation.

"I think it's a complete crock," said Russ Holdstein, a Bay Area venture capitalist who derives most of his income from investments in start-up technology companies, real estate partnerships and other small businesses. He sits on the boards of several firms and teaches entrepreneurship at UC Berkeley.

"If you have an opportunity to grow your business by hiring an extra person, that means you can support more sales and more profits," Holdstein said. "Whether it's taxed at 32%, 36%, 38% or 40%, you still wind up with a net gain there. I don't know anybody who's going to say, 'Oh, gee, I'm not going to hire another employee because my tax rate went up.'"

Here is what is known about small-business owners and the taxes they pay:

Of the nation's 145 million individual income tax filers, 25 million report flow-through business income from active participation in sole proprietorships, farm proprietorships, Subchapter S corporations, partnerships or rental activities.

Of those 25 million, 940,000 are in the top two tax brackets and would pay higher taxes under Kerry's plan, according to the Treasury Department. The Tax Policy Center estimated the number at 995,000.

Of those in the latter figure, 487,000 are classified as sole proprietors because they report income on Schedule C of their tax returns, which takes in everything from business profits to speaking fees. Only 71,000 claim deductions for workers' wages.

In addition to the Schedule C filers, about 344,000 report income from partnerships and 418,000 have Subchapter S income, according to the Tax Policy Center. (The three categories total more than 995,000 because some filers report more than one type of business income.)

The Tax Policy Center said it could not determine from its data how many of the partnership and Subchapter S filers had employees.

Even so, the available data indicated that roughly half of the people defined by Bush as job creators had no employees.

One is Lynne Cheney, wife of the vice president. She listed \$44,580 in consulting fees on the Cheneys' 2003 tax return, qualifying her as a small-business owner under the president's definition. But the only person on her payroll was herself.

Cheney was unavailable for comment. Her press secretary, Maria Miller, said she had received most of the consulting income as a director of Reader's Digest, a position she resigned from last October.

"She had no personal employees," Miller said. "As a board member, she was providing advice and counsel. So it really wouldn't be a small business."

"Lynne Cheney exactly fits who the president is talking about," said George Plesko, a business tax expert at MIT's Sloan School of Management. "The Cheneys reported more than a million dollars in income. Mrs. Cheney is a consultant, she makes good money doing it, and she benefited disproportionately from the tax bill.

"The president's saying this person is an entrepreneur. I'll buy that. But she's not creating any jobs."