January 3, 2000

Alan,

Attached is an article I plan to submit to the State Journal. Please read and critique.

In one place I state that not being able to deduct advertising as a business expense approximately doubles its cost to the advertiser. Am I wrong? A few years ago, I calculated the real cost of a business expense as follows:

Under the current tax system, the business expense subsidy is over 50%. This is because corporate profits get taxed twice, once with the corporate income tax and again with the personal income tax, when the remaining profit is distributed as stock dividends. The current corporate tax rate is as follows:

  15% on the first $50,000
  25% on the next $25,000
  34% on the next $25,000
  39% on the next $235,000
  34% on the remainder

For our purposes, we will assume an average corporate tax rate of 35%. The personal income tax rate on taxable income over $34,000 is 28%. The combined rate is R, where I is the income subject to tax and T is the total tax:

$$T = .35I + .28(I - .35I)$$
$$= .35I + .28(.65I)$$
$$= .35I + .182I$$
$$= .532I$$

$$T = R \times I$$
$$R = T/I$$
$$= .532I/I$$
$$= .532, \text{ or } 53.2\%$$

Have the tax rates changed since I wrote the above? Does my theory hold water?

Steve