Plymouth Institute for Free Enterprise

Reduce Capital Gains Taxes

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TOPLINE: Federal and state lawmakers should reduce capital gains taxes.

BACKGROUND: Taxpayers who sell capital assets like stocks, houses, and business properties owe capital gains taxes on the amount of gain relative to their basis in the asset. Roughly speaking, an asset's basis is the amount that is treated as having been invested into the asset prior to the realization of a gain. An asset's basis is not adjusted for inflation, so if an asset, say, doubles in value along with all other prices in the economy, the owner of the asset would owe tax on that purely inflationary gain.

The top federal tax rate on long-term capital gains is 23.8%, including a top rate of 20% plus an additional 3.8% net investment income tax (NIIT) on certain investment income. Short-term gains are taxed at up to a 40.8% rate federally. Most states also tax capital gains income as ordinary income, which adds an extra layer of tax of about 5% in a typical state, but as high as 13.3% in California.

Action Items (Congress and States):

- **Reduce the federal long-term capital gains tax rate** to a flat 15% rate.
- **Reduce the federal short-term capital gains tax** to a flat 20% rate or less.
- **Consider indexing capital gains for inflation**.
- **Increase the thresholds for the small business stock exclusion** from $75 million in gross assets to $100 million and increase the maximum exclusion amount from $15 million to $20 million.
- **States should reduce their capital gains tax rates**.

How It Would Make Life More Affordable:

- Reducing capital gains taxes would limit double taxation and encourage Americans to save and invest more and to start more new businesses.
- A lower, flatter capital gains tax would streamline financial markets and reduce the lock-in effect (where people delay selling assets like houses and stocks to delay taxes until a more opportune time).
- More investment, saving, and entrepreneurship would grow America's capital stock and productive capacity and expand the supply of goods and services.

Related Legislation: Capital Gains Inflation Relief Act (S. 798, H.R. 1857).

BOTTOMLINE: Capital gains taxes discourage Americans from saving, investing, creating, and building wealth. By limiting investment, capital gains taxes reduce productivity and wage growth.