



BACKGROUND ON BUSH ADMINISTRATION CAPITAL GAINS TAX

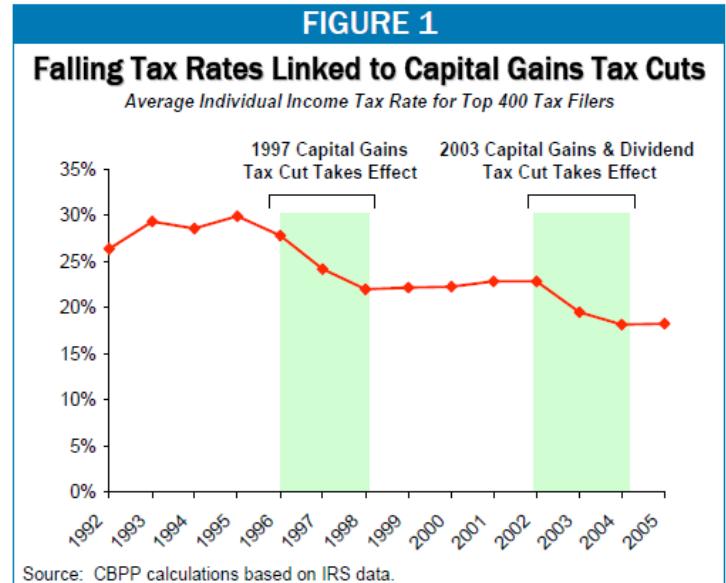
The top 400 wealthiest Americans paid on average only 18% of their income in federal individual income taxes in 2005, down from 30% in 1995.¹

The major source for these waning rates is the capital gains tax cuts enacted through the 1997 **Taxpayer Relief Act (TRA)** and extended by the 2003 **Jobs and Growth and Tax Relief Reconciliation Act (JGTRRA)**. The TRA reduced the top tax rate on long-term capital gains from 28% to 20%, and the JGTRRA lowered it further to 15%, while also setting the tax rate for dividends equal to the tax rate for capital gains.²

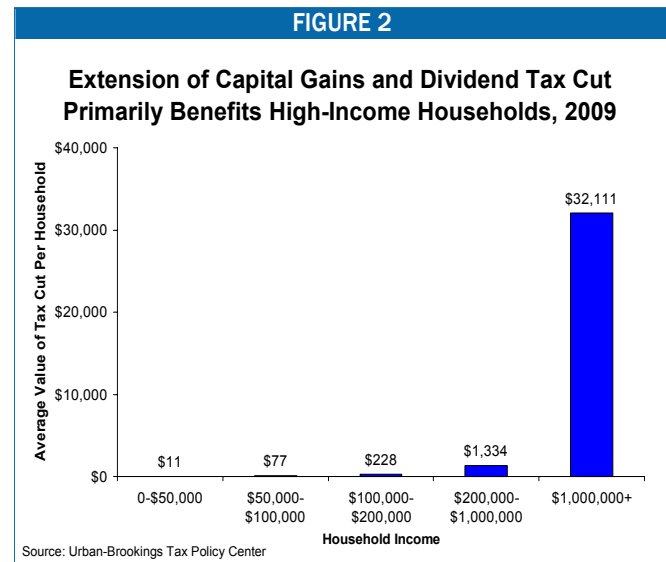
In 2005, the top 1 percent of filers derived 54% of their income from capital gains, and an additional 6% from dividends.³ The **top 400** filers have enjoyed huge gains in pre-tax incomes. **The average pre-tax income of this group rose by 235%** (\$150 million) between 1992 and 2005, after adjusting for inflation.⁴

In May 2006, Congress enacted the **Tax Increase Prevention Reconciliation Act of 2005 (TIPRA)**, which extended through the end of 2010 the reduced rates on capital gains and dividends originally enacted by JGTRRA.⁵

According to Center on Budget and Policy Priorities (CBPP) analysis, “In 2009, 72 percent of the benefits of extending the tax cuts would flow households with incomes above \$200,000”⁶ The same CBPP report finds that over half of all



Source: Aron-Dine, “Capital Gains Tax Cuts Slashed Taxes of Top 400, While Their Incomes Soared,” CBPP, Mar 27, 2008.



Source: Friedman & Richards, “Capital Gains and Dividend Tax Cuts,” CBPP, Jan 30, 2006.

¹ Aviva Aron-Dine, “Capital Gains Tax Cuts Slashed Taxes of Top 400, While Their Incomes Soared,” Center on Budget and Policy Priorities, (CBPP) March 27, 2008.

² Id.

³ Id.

⁴ Id.

⁵ Greg Lieserson & Jeffrey Rohaly, “Distribution of the 2001-2006 Tax Cuts: Updated Projections, July 2008,” Urban Institute-Brookings Institute Tax Policy Center, July 2008.

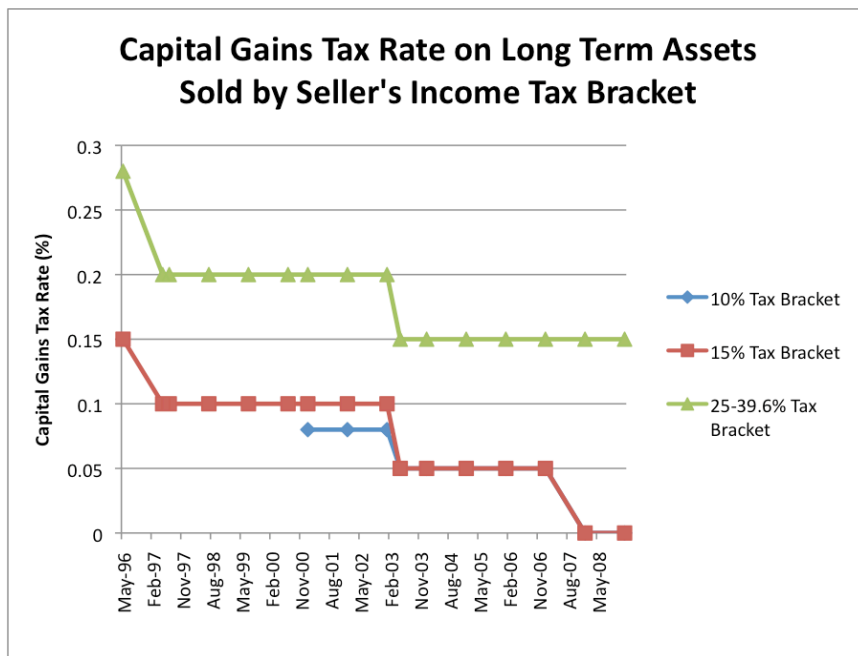
⁶ Joel Friedman & Katherine Richards, “Capital Gains and Dividend Tax Cuts: Data Make clear that High-Income Households Benefit the Most,” Center on Budget and Policy Priorities, January 30, 2006.



capital gains and dividend income flows to the 0.2 percent of households with annual incomes over \$1 million. 78 percent of this income goes to those households with income over \$200,000, which account for about 3 percent of all households.⁷

Investigation by the Joint Tax Committee (JTC) and the non-partisan Congressional Research Service shows that the capital gains and dividend tax cuts do not promote growth but actually cause a reduction in long-term growth.⁸ The JTC discovered that if the capital gains and dividend tax cuts were made permanent, \$30 billion a year would be lost in revenues. Aviva Aron-Dine of CBPP found that this \$30 billion loss, or \$25 billion in 2006 terms, costs “about twice what the federal government spent last year on Pell Grants to help low-income students attend college and more than twice what it spent on the Environmental Protection Agency, the Head Start Program, or the National Science Foundation.”⁹

Capital Gains Tax Rates:



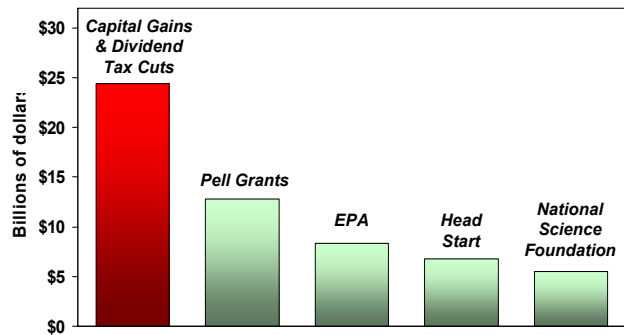
⁷ Id.

⁸ Aviva Aron-Dine, “The Effects of the Capital Gains and Dividend Tax Cuts on the Economy and Revenue: Four Years Later, A Look at the Evidence,” CBPP, July 12, 2007; Jane Gravelle, “Dividend Tax Relief: Effects on Economic Recovery, Long-Term Growth, and the Stock Market,” Congressional Research Service, updated Feb 14, 2005.

⁹ Aviva Aron-Dine, “The Effects of the Capital Gains and Dividend Tax Cuts on the Economy and Revenue: Four Years Later, A Look at the Evidence,” CBPP, July 12, 2007.

FIGURE 2

Annual Revenue Loss From Capital Gains and Dividend Tax Cuts Exceeds Spending on Key Priorities



Source: CBPP calculations based on Congressional Budget Office and Joint Committee on Taxation data. Reflects 2006 program costs and the \$30 billion annual revenue loss from extending the tax cuts, scaled to the size of the economy in 2006.

Source: Aron-Dine, “The Effects of the Capital Gains and Dividend Tax Cuts on the Economy and Revenue: Four Years Later, A Look at the Evidence,” CBPP, July 12, 2007

Source: Data taken from Tax Foundation, “Federal Capital Gains Tax Rates 1988-2011,” at www.taxfoundation.org/files/fedcapgainstaxrates-20080527.pdf.

*Note: From July 29, 1997 to July 21, 1998, the long-term capital gains tax applies only to assets sold after 18 months. Assets sold after 12-18 months had a 15% tax for taxpayers in the 15% bracket and a 28% rate for all higher brackets. Also, from January 1, 2001 until May 5, 2003, the capital gains rate shown applies only to assets sold after five years. For assets sold after 1 to 5 years during this time period, individuals in 10% and 15% income tax bracket paid a 10% capital gains tax rate, while all other tax income brackets paid a 20% tax rate.



**Excerpts from Center for Budget and Policy Priorities
“Experts Agree that Capital Gains Tax Cuts LOSE Revenue”¹⁰**

Cutting capital gains rates reduces revenues over the long run. That’s the conclusion of the federal government’s official revenue-estimating agencies, as well as outside experts and the Bush Administration’s own Treasury Department.

- The non-partisan Congressional Budget Office (CBO) and the Joint Committee on Taxation have estimated that *extending the capital gains tax cut enacted in 2003 would cost \$100 billion over the next decade*. The Administration’s Office of Management and Budget include a similar estimate in the President’s budget.

While a capital gains tax cut can lead investors to rush to “cash in” their capital gains when the lower rate first takes effect, it does not raise revenue over the long run.

- Especially when a capital gains cut is *temporary*, like the 2003 tax cut that Gibson cited, investors have a strong incentive to sell stocks and other assets in order to realize their capital gains before the capital gains tax rate increases. This can cause a short-term increase in capital gains tax revenues, as happened after the 2003 tax cut.
- Capital gains revenues also increased after 2003 because the stock market went up. But the stock market increase was *not* a result of the 2003 tax cut, as a study by Federal Reserve economists found. European stocks, which did *not* benefit from the U.S. capital gains tax cut, performed as well as stocks in the U.S. market in the period following the tax cut.
- To raise revenue over the long run, capital gains tax cuts would need to have extraordinary huge, positive effects on saving, investment, and economic growth that virtually no respected expert or institution believes they have. In fact, experts are not even sure that the long-term economic effects of these capital gains tax cuts are positive rather than negative.

One reason is that preferential tax rates for capital gains encourage tax sheltering, by creating incentives for taxpayers to take often-convoluted steps to reclassify ordinary income as capital gains. This is economically unproductive and wastes resources. The Urban-Brookings Tax Policy Center’s director Leonard Burman, one of the nation’s leading tax experts, has explained, “shelter investments are invariably lousy, unproductive ventures that would never exist but for tax benefits.” Burman has concluded that, “capital gains tax cuts are as likely to depress the economy as to stimulate it.”

Middle-income families derive only a miniscule benefit from the 2003 cuts in capital gains and dividends.

The myth that tax cuts pay for themselves hinders a debate on the nation’s budget priorities — and its serious long-term budget problems and the tough choices we must make to address them — by creating the illusion of a free lunch. Such free lunches do not exist. Capital gains tax cuts either make the nation’s daunting long-term budget problems even more severe or consume scarce resources (primarily to the benefit of the most well-off) that could otherwise be used for purposes such as moving toward universal health coverage or improving the educational system.

¹⁰ Center on Budget and Policy Priorities, “Experts Agree that Capital Gains Tax Cuts LOSE Revenue,” Policy Points, May 7, 2008.