CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

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JEC Study Explains Optimal Capital Gains Tax Policy: Lessons from the 1970s, 1980s, and 1990s

WASHINGTON, DC — Joint Economic Committee Chairman Jim Saxton (R-NJ) released a study today entitled Optimal Capital Gains Tax Policy: Lessons From the 1970s, 1980s, and 1990s, which explores a myriad of issues surrounding the current capital gains tax debate by analyzing capital gains data over the past two decades.

This study is important because the capital gains tax rate was altered several times over the past two decades. For instance, in 1974, the highest marginal tax rate on capital gains was 35 percent, and a series of cuts lowered it to 20 percent by 1982. The 20 percent rate remained in effect until 1987, when it was raised to the current 28 percent level.

"The response to these rate changes can be used to estimate the actual effects of changes in capital gains tax rates on the tax base and the revenue derived from the tax. This is a good example as to why this information is helpful in guiding us as we search for an optimal capital gains tax policy," stated Saxton.

The study demonstrates how a lower capital gains tax rate will: (1) release capital resources that many investors continue to hold in order to delay or avoid tax liability and (2) reduce an impediment to the purchase and sale of capital assets. The study concludes that both of these factors will improve the efficiency of capital markets and benefit the entire economy. Furthermore, the effective capital gains tax rate is *highest* for those taxpayers earning the *lowest* rates of return on their ownership of capital assets.

This inverse relationship between rate of return and the effective tax rate is both unfair and inefficient. Indexing would eliminate this discriminatory element of the current system. Based on this analysis, the capital gains tax rate should be cut substantially, **and capital gains should be indexed to adjust for the effect of inflation.**

This study discusses at length how the allocation of the capital gains tax burden is unfair, discriminatory, and highly inconsistent with basic principles of taxation. Moreover, cutting the capital gains tax rate from 28 percent to 20 percent would provide a substantial efficiency gain without any significant loss in revenue. From the efficiency standpoint, however, even the 20 percent rate is too high because the size of excess burden of taxation is very high in the range near the maximum-revenue rate. These findings suggest that the optimal capital gains rate is 15 percent or less.

For a copy of this study or more information please contact the JEC at (202) 224-5171.

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