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CRS Report for Congress

Capital Gains Tax Rates and Revenues

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Summary

The taxation of individual capital gains income is a perennial topic of debate in Congress. Taxes on long-term capital gains income were reduced in 1997 and again in 2003. The holding period to qualify for long-term capital gains treatment was reduced in 1998. This report provides historical information on the holding period, maximum statutory tax rate, and revenues from the taxation of individual capital gains income. This report will be updated as legislative action warrants or as new data become available.

Since the enactment of the individual income tax in 1913, the appropriate taxation of capital gains income has been a perennial topic of debate in Congress. Almost immediately upon enactment, legislative steps were initiated to change and modify the tax treatment of capital gains and losses. Since 1913, at least twenty major legislative changes and countless minor changes have been enacted. Capital gains tax rates were last reduced in 2003 while the holding period to qualify for long-term capital gains treatment was reduced in 1998.[1]

In May 2003, the 108th Congress passed the Jobs and Growth Tax Relief Reconciliation Act of 2003. Under this act, the maximum tax rate on long-term capital gains income was reduced to 5% (0% for tax years after 2007) for taxpayers in the 10% and 15% marginal income tax brackets. The maximum capital gains tax rate was reduced to 15% for taxpayers in marginal income tax brackets exceeding 15%. The act also repealed the special capital gains tax rates for assets held five years or longer. These changes were originally effective for assets sold or exchanged on or after May 6, 2003, and before January 1, 2009. The Tax Increase Prevention and Reconciliation Act of 2005 extended these lower rates through December 31, 2010.

[1] See CRS Report 98-473, *Individual Capital Gains Income: Legislative History*, by Gregg A. Esenwein.

Under current income tax law, a capital gain or loss is the result of a sale or exchange of a capital asset. If the asset is sold for a higher price than its acquisition price, then the sale produces a capital gain. If the asset is sold for a lower price than its acquisition price, then the sale produces a capital loss.

Capital assets held longer than 12 months are considered long-term assets while assets held 12 months or less are considered short-term assets. Capital gains on short-term assets are taxed at regular income tax rates. Gains on long-term assets are taxed at a maximum tax rate of 15%.

Ideally, a tax consistent with a theoretically correct measure of income would be assessed on real (inflation-adjusted) income when that income accrues to the taxpayer. Conversely, real losses would be deducted as they accrue to the taxpayer. In addition, under an ideal comprehensive income tax any untaxed real appreciation in the value of capital assets given as gifts or bequests would be subject to tax at the time of transfer.[2]

Obviously, the current law tax treatment of capital gains income varies considerably from the ideal treatment under a comprehensive income tax. One response to this deviation from a comprehensive approach to the taxation of capital gains income has been a call for further reductions in the tax rates applicable to capital gains income.

One argument for lowering capital gains taxes has focused on the benefits of reducing "lock-in" effects. Lock-in occurs because the income tax liability on capital gains income can be deferred until the asset is sold. Tax deferral creates a bias because individuals faced with a large lump-sum tax are reluctant to sell their capital assets even though, on a pre-tax basis, they could earn a higher rate of return on an alternative investment. This "lock-in" effect tends to retard the efficient allocation of resources in the economy with tax considerations tending, in some cases, to dominate other market forces. Proponents of capital gains tax reductions argue that cutting capital gains taxes will reduce "lock-in" effects and free up resources, increase savings and stimulate economic growth, and make the tax code less complex. Critics are concerned about the distributional effects, possible tax shelter abuses, and the revenue losses associated with reductions in capital gains taxes.

Some commentators argue that reducing taxes on long-term capital gains will not reduce federal revenue but will, in fact, result in increased revenue. It is argued that as taxes are reduced on capital gains, "lock-in" is reduced, which increases realizations and investments in capital assets. The net effect is to increase federal revenues.

Although taxes on increased capital gains realizations would offset some of the initial cost of cutting capital gains taxes, there is considerable uncertainty about the magnitude of the unlocking effects. It appears that over the long-run, the revenue generated from an increase in capital gains realizations accompanying a tax cut would not be large enough to offset the static revenue loss from the tax cut itself. A net revenue gain is also less likely under current law than it was in the past, in part because the increase in realizations would be taxed at lower rates than would have been the case in the past.

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[2] For more information see CRS Report 96-769, *Capital Gains Taxes: An Overview*, by Jane G. Gravelle.

The following two tables present background information that may prove helpful to policy makers as they debate the merits of further capital gains tax changes in the 110th Congress. **Table 1** shows the statutory maximum tax rates on both ordinary income and long-term capital gains income since the adoption of the federal individual income tax in 1913. This table also shows the holding period required for capital assets to qualify for long-term capital gains tax treatment.

Two major observations can be drawn from the data in **Table 1**. The first item is that with the exception of the first nine years, the maximum statutory tax rate on long-term capital gains has been substantially lower than the maximum statutory tax rate on other forms of income.[3] The second observation is that the current maximum statutory tax rate on long-term capital gains income is lower than it has ever been in the post World War II time frame.

Table 2 shows realized capital gains and federal individual income taxes paid on realized capital gains for selected years 1955 through 2002. It also shows CBO estimates of realized capital gains and taxes paid on capital gains for 2003 through 2016.

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[3] The effective marginal tax rate (the tax rate that a taxpayer actually faces) on both ordinary income and long-term capital gains income can be higher than the statutory tax rate because of the interaction of various other provisions in the tax code.

Table 1. Statutory Marginal Tax Rates on Long-Term Capital Gains Income

(1913-2010)

Year	Maximum Tax Rate on Ordinary Income (%)	Maximum Statutory Tax Rate on Long-term Capital Gains Income (%)	Holding Period for Long-term Capital Gains Treatment (years)
1913-21	7 - 77	7 - 77	—
1922-33	24 - 73	12.5	2
1934-37	63 - 79	18.9 - 23.7	1
1938-41	79 - 81.1	15	1.5
1942-51	82 - 94	25	0.5
1952-53	92	26	0.5
1954-63	91	25	0.5
1964-67	70 - 77	25	0.5
1968	75.3	26.9	0.5
1969	77	27.5	0.5
1970	71.8	30.2	0.5
1971	70	32.5	0.5
1972-75	70	35	0.5
1976	70	35	0.5
1977	70	35	0.75
1978	70	33.8	1
1979-80	70	28	1
1981	70	20	1
1982-83	50	20	1
1984-86	50	20	0.5
1987	38	28	1
1988-90	28	28	1
1991-92	31	28	1
1993-96	39.6	28	1
1997	39.6	20	1.5
1998-99	39.6	20	1
2000	39.6	20	1
2001	39.1	20	1
2002 - 2003	38.6	20	1
2003 (May)- through 2010	35.0	15	1

Source: Statistics for 1913 through 1999, *The Labyrinth of Capital Gains Tax Policy*, by Leonard E. Burman. Brookings Institution Press, Washington, D.C. 1999. Statistics for 2000 through 2003, CRS.

Table 2. Realized Capital Gains and Taxes Paid on Capital Gains

(billions of dollars)

Year	Realized Capital Gains	Taxes Paid on Capital Gains	Maximum Statutory Tax Rate (%) on Long-term Gains
1955	9.9	1.5	25.0
1960	11.7	1.7	25.0
1965	21.5	3.0	25.0
1970	20.8	3.2	30.2
1975	30.9	4.5	35.0
1980	74.1	12.5	28.0
1985	172.0	26.5	20.0
1990	123.8	27.8	28.0
1995	180.1	44.3	28.0
1996	260.7	66.4	28.0
1997	364.8	79.3	20.0
1998	455.2	89.0	20.0
1999	552.6	112.0	20.0
2000	644.0	127.0	20.0
2001	349.0	66.0	20.0
2002	269.0	49.0	20.0
2003	323.0	51.0	15.0
2004	499.0	72.0	15.0
2005	643.0	97.0	15.0
2006	729.0	110.0	15.0
2007	708.0	107.0	15.0
2008	699.0	102.0	15.0
2009	698.0	102.0	15.0
2010	796.0	116.0	15.0
2011	547.0	103.0	20.0
2012	649.0	123.0	20.0
2013	661.0	125.0	20.0
2014	676.0	127.0	20.0
2015	694.0	130.0	20.0
2016	715.0	133.0	20.0

Source: Department of the Treasury for years 1955 - 2002. CBO for 2003-2015 from *The Budget and Economic Outlook: Fiscal Years 2008 - 2017*, January 2007.