THE NEW ENGLAND COUNCIL

Committee Update

September 21, 2012

Yesterday's debate on capital gains in a rare joint session of the House Ways and Means and the Senate Finance Committees held few surprises, although members on both sides of the aisle clearly recognized the difficulty of finding consensus on an issue that has traditionally split along party lines. With the current capital gains rate set to expire at the end of the year, lawmakers face a particularly daunting task as the so-called "fiscal cliff" looms, with entrenched views on both sides as to the tax treatment of capital gains in the context of continued economic recovery. "As we work on comprehensive tax reform, treatment of capital gains is one of the most difficult issues we face," said Senator Max Baucus, Senate Finance Committee Chair. If no action is taken before year-end, the capital gains rate would jump from 15 percent to 20 percent, along with increases in the rates on ordinary income, dividends, estates and payrolls. In addition, the effective tax rate on capital gains will also increase further as a 3.8 percent tax on investment income kicks in on January 1, 2013.

During yesterday's hearing, Congressman Dave Camp (R-MI), Chair of the House Ways and Means Committee, characterized raising the capital gains tax as a form of "double taxation." He argued, "As we consider the economic impact of the tax burden associated with capital gains, it is critical that we focus on the total integrated rate, which is nearly 45 percent, not just the statutory rate of 15 percent." He also noted, "regardless of what rate we apply to capital gains, we should strive to retain parity between the rates for capital gains and dividends. Just as we need to eliminate the "lock-out" effect that our worldwide tax system imposes on foreign earnings, we also should not restore the "lock-in" effect on domestic corporate earnings that makes it more tax-efficient to retain earnings inside a corporation when it might be more productive to push the cash out to shareholders so they can reinvest it elsewhere in the economy."

Senate Finance Chair Max Baucus argued that the capital gains tax rate, along with dividend rates, must be considered along with the tax rates for personal and corporate income. “Our entire tax code – including its treatment of capital gains – needs to be rebuilt for the 21st century economy. We need a system focused on broad-based economic growth and jobs,” he said. Baucus also said, “Last year, capital gains represented half the income of the top .1 percent of earners, but three percent for the lowest 80 percent of taxpayers," he said. "Low capital gains rates are the main reason why many wealthy individuals pay lower tax rates than middle class families." During the hearing, Baucus questioned how realistic it is to lower taxes on wages, if the capital gains tax is not raised, given the need for revenue in the current budgetary environment.

Senate Finance Committee Ranking Member Senator Hatch (R-UT) explored which tax rates would produce the maximum revenue to the federal government. Senator Ron Wyden (D-OR) proposed a sliding scale, increasing the rate on capital gains as individuals receive greater investment income. Congressman Richard Neal (D-MA) pressed on the impact of the Alternative Minimum Tax (AMT), which he said Congress would patch again.

David Brockway of Bingham McCutchen LLP, a former Joint Committee on Taxation chief of staff who helped craft tax reforms in 1986, testified that it is not “politically feasible” to lower rates for all income levels without raising them on investments. After the hearing, he noted “I just don’t think the math works. That is the hard reality of comprehensive tax reform.”

Click here to watch the entire hearing on C-SPAN.

Click here to read the written testimony of the witnesses.