Joint Committee on Taxation Capital Gains Tax Cut Estimates Are Based on Highly-Questionable Assumptions

To lower the estimated cost of the 1999 House GOP tax plan's capital gains tax cut, the Joint Committee on Taxation assumed that the plan would induce stockholders to increase their capital gains realizations by 25 percent compared to what they would otherwise do. This assumption had the effect of reducing the estimated cost of the capital gains tax cut by three-fourths.

The Joint Committee assumed such a sharp projected increase in capital gains realizations in response to the tax cut despite the fact that the aftermath of the most recent capital gains tax reduction in 1997 offers no evidence to support such an assumption.

- In the two years prior to the 1997 capital gains tax reduction, capital gains realizations grew by 70 percent, including a 45 percent jump in 1996 alone. This occurred, of course, in response to the strong performance of the stock market, which rose by a total of 56 percent in 1995 and 1996.
- In 1997, the stock market had another strong year, surging by 30 percent. But despite the sharp reduction in the capital gains tax rate that took effect on May 5, 1997, capital gains realizations grew at only about the same rate as the stock market.
- In fact, the 33 percent rise in capital gains realizations in 1997 was considerably less than the 45 percent jump in the previous year when there was no capital gains tax relief.

As Deputy Assistant Treasury Secretary and former CBO Senior Analyst Leonard E. Burman notes in his recent book on capital gains:

> "Careful econometric studies find that capital gains are relatively unresponsive to statutory changes in tax rates . . . [but] a large difference between the rates on capital gains and other income gives taxpayers a strong incentive to convert other income into capital gains. . . . [This] wastes society's scarce resources by encouraging inefficient tax shelters and distorting the nature of investment."[1]

Citizens for Tax Justice, July 15, 1999

[1] Leonard E. Burman, *The Labyrinth of Capital Gains Tax Policy, A Guide for the Perplexed* (1999), p. 146.