In a recent interview, President Donald Trump revived his administration’s proposal for a change to the way capital gains are taxed. Capital gains — the income received from the profitable sale of a capital asset — are taxed at a lower marginal rate than ordinary income, but the value of that sale is not currently adjusted for inflation over the time in which the asset was held. The policy being considered by the Administration would account for inflation when considering the value of such gains and would therefore enhance the tax preference that already exists. Below is a brief look at how the tax on capital gains works in our system, and what the proposed change would mean for the national debt.

**What is the Capital Gains Tax?**

Capital gains are recorded separately when filing taxes. For example, if shares of corporate stock were purchased for $10,000 and sold 10 years later for $20,000, the $10,000 profit would be considered a capital gain and enjoy a preferential tax rate. If a capital asset is sold at a loss, some or all of that loss may offset other gains or be deducted from taxable income.

Capital gains on assets that are held for less than one year are known as short-term capital gains and are currently taxed at the same rate as ordinary income for individuals. Capital gains on assets that are held for more than one year are known as long-term capital gains and are taxed at rates of 0, 15, or 20 percent depending on an individual’s income. Historically, the capital gains tax rate for long-term assets has generally been lower than the maximum ordinary income tax rate.
What Kind of Assets are Subject to the Capital Gains Tax?

Most of what an individual owns, including securities like stocks and bonds or even “hard” assets such as real estate, can be considered a capital asset. However, most transactions subject to capital gains taxes consist of investments such as stocks and mutual funds. According to the latest data, 75 percent of taxable transactions were from stocks and mutual funds.
Who Pays the Capital Gains Tax?

While the capital gains tax affects anyone selling a capital asset, higher-income individuals are typically subject to the tax more so than average Americans. In 2010, individuals in the top 1 percent income class received more than 18 percent of their income from capital gains. That figure compares to approximately 0.1 percent of income for individuals in the bottom 80th percentile.
How Much Does the Government Receive From Capital Gains Taxes?

Revenue from the tax on capital gains is counted as part of the individual income tax category, but generally accounts for less than 10 percent of such collections. In 2017, taxes from capital gains constituted about 8 percent of individual income tax revenue, totaling $132 billion; CBO anticipates that proportion to decline to around 7 percent by 2028 as capital gain realizations return to their historical average.

Additionally, the revenue from the capital gains tax can be volatile, reflecting changes in economic activity, especially during recessions. For example, revenue from capital gains dropped from $100 billion in 2001 to $58 billion in 2002, a 42 percent decrease in just one year. This same pattern occurred during the 2008 financial crisis, with capital gains revenue decreasing by 48 percent from 2008 to 2009.
How would the Proposed Change Affect our Fiscal Situation?

The Administration is considering a change that would adjust capital gains for inflation, thereby reducing their tax burden. Consider the previous example of a $10,000 investment in stocks and selling it 10 years later for $20,000. Accounting for inflation, a $10,000 purchase in June 2008 had the same buying power as $11,516 in June 2018 so the seller would be subject to a capital gains tax on $8,484 as opposed to being taxed on the original $10,000 profit.

No official policy change has been announced by the Administration, but the Tax Policy Center estimated that it could increase the national debt by $20 billion per year. Following last year’s fiscally irresponsible tax bill, policymakers should look for ways to implement tax reforms that improve our fiscal situation rather than make it worse.

Related: Five Things That We Have Learned Since The Tax Cuts Were Enacted

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