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EXTRA POINT

July 1997

Where Economics and Politics Meet

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According to the Joint Tax Committee, 75 percent of the value of the tax cuts in the tax bills before the Congress would go to households earning less than $75,000 annually. According to the Treasury Department, under these tax bills the top 1 percent of taxpayers get the same amount of tax relief as the bottom 60 percent of taxpayers. Can both statements be true? Actually, yes.

It should surprise no one that, in Washington, something can be both more and less at the same time. While such a phenomenon might defy Newtonian physics, it occurs with ease in that hazy corner of the galaxy where economic statistics and politics come together.

The main culprit in the debate, not surprisingly, is capital gains relief. Under the House bill and according to the JTC, capital gains relief raises receipts in the first two years, reduces receipts in the next two, raises receipts again in the fifth, and loses money thereafter. Casual observers will probably think there's something fishy going on when a tax rate cut is projected to raise revenues. Actually, this curious result is due to the well-established principle that taxpayers will accelerate their realizations in the face of capital gains relief, but that there is a limited pool of capital gains taxpayers have accrued over the years and will want to realize once the tax rate is lower.

Faced with such an interesting pattern of receipts, how does one calculate the tax distribution? For the first year? Over the first five years, as the JTC prefers? Over 10 years, as Treasury prefers? As the average of the 10 years? As the discounted value of all future tax cuts? The answer can obviously make a big difference.

Another dimension to the capital gains conundrum is the treatment of the accelerated capital gains taxes paid. Remember, the capital gains cut raises revenue in the first two and fifth years because some individuals with accrued capital gains realize those gains, and pay tax, sooner rather than later. The JTC takes the common-sense approach that a tax is a tax is a tax. If more taxes are paid, it's a tax increase. Thus, according to JTC, the increased revenues in the first two and the fifth years represent a tax increase.

The Treasury argues that the taxpayer had accrued a capital gain and that he or she would have sold the asset and realized at some point anyway. At that time, the capital gains would have faced a higher rate but for the tax bill under consideration. Therefore, the fact that the tax was paid now rather than later is immaterial to whether the taxpayer faces a lower rate or not, or whether the taxpayer gets a tax cut or not.

Analytically, the Treasury has a point, but only up to a point. Perhaps the gain would not have been realized in the future without an offsetting capital loss from the sale of some other asset. In this case, no tax would have been paid, so the fact that the asset was sold earlier actually means the capital gains tax paid may represent a tax increase. Or perhaps the gain would never have been realized because the asset would have carried over to the owner's estate and therefore qualified for a step-up in basis. Again, this would mean the tax paid today is a clear tax increase.

Tax distribution tables have once again played a central role in the developing a tax bill. Whether these tables should be used as props in the fairness debate is a question for another day. But those who use them, and those who want to understand them, need to understand as well that there's a lot more art than science involved in producing these tables. And art is often a matter of taste and preferences.