GOP Hopes Big Wave of Capital Gains Tax Prepayments Will Offset 95 Percent of Tax Plan's Cost in FY 2001

The official congressional estimates of the cost of the GOP's proposed capital gains tax cut show an unusual blip in fiscal 2001, when the capital gains tax cut is supposed to *boost* federal revenues by a net $15.5 billion. Likewise, the Joint Committee on Taxation's distributional table showing its controversial estimates of the effects of certain of the tax cuts in calendar 2000 claims that the overall tax cut bill will be a net *tax increase* of $16.4 billion in that year.

- # After accounting for the small non-capital-gains tax cuts that are included in the distribution table, this means that **the Joint Committee expects a net capital gains tax *increase* in calendar 2000 of $18.9 billion as a result of the tax cut plan.**

Distributional Effects of the GOP Tax Plan In Calendar Year 2000 According to the Joint Committee on Taxation

Income Category	Change in Federal Taxes
Less than $10,000	$ –0.0 billion tax reduction
10,000 to 20,000	–0.1 billion tax reduction
20,000 to 30,000	–0.1 billion tax reduction
30,000 to 40,000	–0.2 billion tax reduction
40,000 to 50,000	–0.1 billion tax reduction
50,000 to 75,000	+0.2 billion tax increase
75,000 to 100,000	+0.7 billion tax increase
100,000 to 200,000	+2.9 billion tax increase
200,000 and over	+13.1 billion tax increase
Total, All Taxpayers	**$ +16.4 billion tax increase**

(1) Includes AMT credit limitation repeal, student loan interest deduction, elderly caretaker exemption, capital gains, and self-employed health insurance deduction.

Futher Calculations–

Less: Non-capital-gains items in JCT table	–2.4 billion tax reduction
Capital Gains, Net	**$ +18.9 billion tax increase**
Less: Effect of capital gains rate cut (with JCT "feedback" effect)	–4.0 billion tax reduction
Hoped-for Capital Gains Tax Prepayments in 2000	**$ +22.8 billion tax increase**

Sources: Joint Committee on Taxation, "Distributional Effects of the Conference Agreement for H.R. 2488, Calendar Year 2000," 8/5/99, and "Estimated Budget Effects of the Conference Agreement for H.R. 2488, Fiscal Years 2000 - 2009," 8/4/99. Calculations at end of table by Citizens for Tax Justice.

What's going on here? It turns out that this remarkable capital gains prediction reflects congressional Republicans' hopes about the effects of a novel provision in the tax plan allowing taxpayers to pay capital gains taxes on unrealized gains in the year 2000 in order to make their assets eligible for inflation indexing in the future.

Under the bill's "mark-to-market" rule, in the year 2000, taxpayers can choose to pay taxes on their unrealized capital gains without actually having to sell their stocks and bonds. The GOP's theory is that many high-income taxpayers will decide to pay additional taxes in the year 2000 in order to cut their taxes on capital gains by even more in the future.

- # The indexing provision will reduce capital gains taxes on future realizations by 30 percent or more depending on how long assets are held. (Shorter holding periods generally produce larger percentage tax reductions from indexing.)

Republicans in Congress claims that the lure of future indexing will persuade taxpayers to pay approximately $23 billion in additional capital gains taxes on their 2000 tax returns compared to what they would otherwise pay (most of the revenue would show up in fiscal 2001). That $23 billion is expected to far more than offset the $4 billion cost that the official estimators would have assigned to the capital gains tax rate cut for calendar 2000 (a figure that itself is probably too low).

- # Put another way, in calendar 2000, **Congress expects taxpayers to pay taxes on about $130 billion more in capital gains than would otherwise be the case** due to their desire to index their assets for inflation in the future.

This huge increase in expected reported capital gains—almost a third more than currently projected—is highly speculative and debatable, of course. By some calculations, hardly anyone would find prepaying capital gains taxes advantageous except those taxpayers who have artificially low tax rates in the year 2000 (due perhaps to utilization of "loss" write-offs). Obviously, no taxpayer will prepay capital gains taxes unless he or she believes that paying taxes early will cost the government a lot more in taxes in future years.

Yet the dubious $22 billion in additional taxes that congressional Republicans hope their prepayment scheme will produce in the short run looms very large in the estimates of the cost of the GOP tax bill in its early years.

- # **Without the hoped-for revenue-raising effects of the prepayment scheme, the official estimate of the cost of the tax plan in fiscal 2001 would jump from $1.1 billion to almost $21 billion.** In other words, capital gains tax prepayments are expected to offset 95 percent of what the tax plan would otherwise cost in fiscal 2001.

Cost of the GOP Tax Plan in FY 2001
Based on the Official Estimates
$-billions

Official Net Cost of Entire Bill	**$**	**–1.1**
Capital gains tax prepayments		+19.7
Cost without prepayments	**$**	**–20.8**
Includes:		
Corporate tax cuts		–4.5
Capital gains without mark to market		–4.2
Income tax rate cuts, etc.		–9.7
Self-employed health insurance		–1.0
Education savings		–0.7
Health (other than self-employed)		–0.3
Pensions		–0.6
IRAs		–0.6
Offsets		+1.1
All other		–0.2
% of Total Cost of the FY 2001 Tax Cuts Offset by Prepayments		**–95%**

Source: Joint Committee on Taxation except prepayments estimated by Citizens for Tax Justice based on JCT figures.

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