EIR Economics

Capital gains tax cut is a parasites' paradise

by Richard Freeman

At the heart of House Speaker Newt Gingrich's (R-Ga.) Contract with America, is the proposal for a 50% cut in the capital gains tax rate, and indexation of capital gains to inflation. The combined effects of the proposed tax cuts would initially hand $180 billion to $210 billion in after-tax profits to speculative parasites—"privateers"—who bankrolled Gingrich and other Conservative Revolution Jacobins into Congress.

The proposal is grand larceny brazenly executed in broad daylight and covered up with the thread-bare cloth of "tax reform."

Lyndon LaRouche, in his Jan. 18 speech to the Schiller Institute's Martin Luther King Conference, stated: "The 'privateers' . . . [are] going to steal everything. And they're going to steal and loot the nation through an instrument called capital gains. You pay more taxes, you get less, and you pay off the pirates, the parasites who make no contribution, who survive on lucky money which they get by running a crooked wheel called the financial speculative market—[such as] Orange County—through capital gains."

Capital gains are gains realized as a result of the appreciation of an asset, whether that asset be stocks and real estate—which are the two biggest forms of capital gains—or a piece of antique furniture, an art work, etc. For example, if one bought an apartment building for $50 million, and sold it two years later for $150 million, then $100 million is one's capital gain, even if the upkeep and repair of the apartment building has not been maintained and the building, in real physical terms, is really worth less than it was two years ago. The object of the speculative economic process that has submerged America since the 1963 assassination of President John Kennedy, has been to rig an appreciation in the market price of paper financial instruments or pieces of land, and then record profits through the instruments' sale. These are capital gains profits. This is part and parcel of the gigantic worldwide financial bubble.

The capital gains tax rate cut, proposed under the Contract with America, has two objectives. First, it is to increase the size of, and give six months or more new life to, the financial bubbles in stocks, derivatives, and real estate. The historical record shows that each time a capital gains tax cut has been enacted during the last 20 years, speculative activity has thrived. Second, it lowers the tax rate that the speculative parasite pays on his ill-gotten gain, which, meanwhile, has been enlarged through the effects of the capital gains tax cut. So the speculator pays less tax on a much bigger take. As Al Capone would say, "Nice work, if you can get it."

As for its effect on society, as the capital gains tax cut-aided speculative bubble grows, it sucks more wealth out of the physical economy and strangles it. More farms and factories close down; more workers are laid off. This contracts the tax revenue base of the U.S. government, because even if lowering the capital gains tax brought in more capital gains tax revenue—it does just the opposite—the effect that the cuts in the capital gains tax has on the economy is greater.

How the capital gains tax cut works

The Contract with America proposal for capital gains tax cuts is summarized in a Jan. 5 document, "Description of Provisions in the Contract with America within the Jurisdiction of the Committee on Ways and Means." It states: "The Contract with America contains three capital gains incentives: 1) a 50% capital gains deduction, 2) indexation of the basis of capital assets to eliminate inflationary gains, and 3) a provision to allow homeowners who sell their homes at a loss to deduct that capital loss." Point one, regardless of when it passes, would be retroactive to Jan. 1, 1995.

The current capital gains tax rate is 28%, and is applicable to all the capital gains that an individual or corporation realizes in the course of a year. For example, let us say that Mr. Boesky realizes a $2 million capital gain. Under current law, Boesky's capital gains tax would be his $2 million capital gain times the current 28% capital gains tax rate, or $560,000. This would leave him an after-tax profit of $1.440 million. Under the proposed new law, Boesky would deduct one-half the $2 million capital gain (or $1 million), which would not be subject to tax. Let us also assume that Mr. Boesky is in the highest personal tax bracket, which is currently 39.5%. Under the proposed change, he would pay tax on the remaining half of his capital gain times his current personal income tax rate. This would mean $1 million times 39.5%. His capital gains tax would be $395,000, leaving him an after-tax profit of $1.605 million. He would earn an extra $265,000 in after-tax profit.

However, historically, the way the capital gains tax works, by intention, is that it simultaneously swells the speculative markets to new heights. So, under the Contract with America, Boesky could realize 1.5 times (or more) as much capital gains as he currently does. Let us assume that under the Contract with America, Boesky realizes $3 million in capital gains, as opposed to the $2 million that he currently does. As a result, his capital gains taxes would be $594,500 but his after-tax profits would rise to $2.4 million—nearly twice current levels.

Indexation of capital gains to inflation, under the Contract with America proposal, would add a whole new element of financial scam, because it indexes the speculator's assets against the inflation rise, but the speculator can borrow money which is not indexed. Indexation would drastically lower the amount of tax the speculator pays, lowering the tax revenue the U.S. government collects, and further increasing the speculator's after-tax profits.

Lies and more lies

In pushing the capital gains tax cut, Gingrich, his congressional cohorts, and think-tanks such as the Heritage Foundation and National Taxpayers Union, blather that the capital gains tax cut is a pro-business tax cut, which will stimulate business formation and help the average taxpayer pay a lower tax. Often, for dramatic effect, they say that the proposal will help the farmer sell his farm, or the poor widow sell her house, which they could not do if they faced high capital gains taxes. How does this colorful palaver stack up against the truth?

- Only 8.5% of all taxpayers pay capital gains taxes, according to the U.S. Treasury Department. That means, 9 out of 10 taxpayers—the average working man—realize no capital gains whatsoever. Moreover, 13.8% of the total dollar amount of capital gains are earned by those who earn $100,000 to $200,000 in income, and 65.3% of the total dollar amount of capital gains are earned by those who earn $200,000 or more. Thus, two-thirds of all capital gains are earned by those with $200,000 or more in income. This minuscule group represents less than 1% of all Americans who file tax returns. They are the prime beneficiaries.
- As for the claim that cutting the capital gains tax will help people sell their homes, the truth is that capital gains on the sale of a principal residence can be deferred indefinitely if the taxpayer purchases a replacement residence of greater or equal value, which happens 90% of the time. According to one source, one-third of capital gains is realized in the stock market, and an additional 45% is realized either from commercial real estate, or housing that is not one's primary residence, but held as an investment. For the last three decades, the stock and real estate markets have had almost no connection to real economic activity, but have been hotbeds of speculation. Thus, 80% of capital gains derive from speculative activity.

Priming the speculative pump

In 1978, the capital gains tax rate was 49%. In that year, Rep. William Steiger (R-Wisc.) introduced legislation which became law which reduced the capital gains tax rate to 28%. That law took effect in 1979. Then, in 1981, one of the provisions of the Kemp-Roth Tax Act reduced the capital gains tax further, to 20%. In 1986, the Tax Reform Act raised the capital gains tax rate back up to 28%.

Between 1978 and 1986, the double-dose of capital gains tax rate cuts—in combination with the 1982 deregulation of the U.S. banking system, and then Federal Reserve Board Chairman Paul Volcker's sky-high interest rate regime—fueled a further speculative boom in America. Let us look at what happened in the capitalization of the New York Stock Exchange (NYSE). The capitalization is the total number of shares times the stock price of each of those shares.

During 1978-86, the capitalization of the NYSE soared from $823 billion to $2,199 billion. This represented an increase of 2.67 times in just eight years, or a compounded rate of growth of approximately 30% per year. The real estate market also boomed. The parasites sponsoring the current capital gains tax rate cut intend to re-create such a boom, intending to give six months of new life to the current cancerous bubble which is strangling the physical economy.

A study by the Joint Committee on Taxation of the U.S. Congress, calculates that if the Contract with America capital gains tax cut version passes, it will increase realized personal capital gains by 70%. But even with that increase, the U.S. government will lose $208 billion in capital gains tax revenues between fiscal years 1995 and 2004. Entitlements and infrastructure will be cut to make up for the lost taxes. The money equivalent will be handed over to the parasites whose non-productive activity is destroying America.