Donald Trump’s Tax Plan Is a Big Capital Gains Mystery

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This week at the Detroit Economic Club, GOP presidential nominee Donald Trump released version 2.o of his tax reform plan.

The details, such as they are, were a little scant in some key areas.

His personal tax rates align with theHouse GOP blueprint’s: 12, 25, and 33 percent. Businesses would face a tax rate of 15 percent (it’s unclear whether this is a business profits tax or a value added tax–VAT). All business expenses could be fully expensed in the year of purchase, rather than subject to piecemeal deductions over many years (i.e., depreciation). Overseas accumulated earnings would be subject to a 10 percent deemed repatriation tax, but it’s unclear what type of international tax reform that’s building a bridge to. The death tax would be repealed.

In a widely panned plank, the average cost of child care expenses would be deductible. As Dan Mitchell of the Cato Institute has pointed out here and here, this is most likely to result in child care providers hiking costs in order to capture the tax subsidy (much like health insurance companies and colleges have done). This deduction is by definition useless to the working poor (who need this help the most) because their taxable income is already zeroed out.

Absent from any of this, apparently, is a position on capital gains. That’s a bit odd for a Republican presidential candidate, even an unorthodox one like Mr. Trump. Every Republican running for president since Reagan has run on a capital gains tax cut, yet Trump fails to provide one here. It’s difficult to see how he plans on a “made in America” investment strategy without lowering the tax code’s double tax on investment (i.e., the capital gains rate).

I say “apparently” because Trump actually does have a proposal on capital gains–a capital gains tax hike, that is. As part of his speech, he pledged to “end the carried interest deduction.” Let’s break that apart for a moment.

First, there is no “carried interest deduction.” Carried interest is a type of capital gain earned by an investment partnership and allocated to a managing partner. It’s a capital gain, and as such it’s taxed at capital gain rates (today, up to 23.8 percent on long term gains). There’s no deduction involved here–whoever is advising Trump on this clearly doesn't know the issue at all. Rather, Trump is calling for a marginal tax rate hike on this type of capital gain, up to his top rate of 33 percent. Kevin Williamson from NRO has pointed out how this will be a particularly harmful tax on start up ventures.

Second, taxing carried interest capital gains as ordinary income is certainly not a new idea. It's supported by President Obama, Hillary Clinton, Bernie Sanders, et al. The new hire on Senator Ron Wyden's (D-Ore.) Finance Committee tax staff, law professor Victor Fleischer, invented the tax increase explicitly as a camel's nose under the tent to tax all capital gains as ordinary income.

Seasoned tax experts on the Right get that this is a trap and they don't fall for the bait. Trump fell for it, or his advisers did. Just a few weeks ago, the leaders of22 conservative groups signed a letter opposing this tax increase. Included as signers were Americans for Tax Reform president Grover Norquist, National Taxpayers Union president Pete Sepp, and David Williams **WMB -0.39%** of the Taxpayers Protection Alliance. This isn't attractive to the tax reform wing of the conservative movement, by any stretch.

Finally, Trump's common cause with the far Left–taxing carried interest capital gains as step one to taxing all capital gains at higher, ordinary rates–will raise almost no money for tax reform. According to both President Obama'sOffice of Management and Budget and Congress' non-partisan Joint Tax Committee, this tax increase would result in a paltry $1 to $2 billion per year in additional tax revenue–out of $3.4 trillion in revenue collected every year by Uncle Sam. This tax increase is not about serious tax reform or raising money–it's about what its liberal authors and patrons say it's about, the eventual ordinary income taxation of all capital gains.

So, given all that, what is Trump's position on capital gains? The fact is, we just don't know. His old tax plan had a small capital gains rate cut, but that's been removed from his campaign website and we have to assume they've started over here. One very reasonable interpretation of this plan is that Trump is proposing that all capital gains be taxed at ordinary rates, meaning a capital gains tax hike from 23.8 percent today to 33 percent under his plan. Until we hear more, I'm not sure what else we're supposed to assume.

Conservatives have a right to expect some clarity on, of all things, the capital gains tax from their GOP nominee. If Trump is looking to bring Republicans home in the run up to election day, he would do well to shed some light here, and soon. Otherwise, the capital gains tax hike his plan does contain will be taken as indicative of his overall position on investment taxation.