



Biden's foolish capital gains tax increase

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Presidential candidate Joe Biden is planning large tax increases if elected in November. He says that the increases would be just for high earners, but his proposals would hit all of us by damaging investment, entrepreneurship and job opportunities.

Perhaps Biden's worst idea is to hike the top capital gains tax rate from 23.8 percent to 43.4 percent. That is a radical proposal. Congress has kept long term capital gains tax rates below rates on ordinary income for most of the past century, and nearly all other advanced economies provide favorable tax rules for gains.

The current U.S. capital gains tax rate including the average state rate is about 28 percent, but the average rate across Europe is just 19.5 percent. Numerous countries do not tax long-term capital gains at all including Belgium, Czech Republic, New Zealand, Singapore and Switzerland.

Why do countries provide low tax rates for capital gains? For one thing, they know that capital is mobile in today's global economy, and it will flow abroad if tax rates are unfavorable compared to foreign trading partners.

Another concern is inflation. If you buy a stock and sell it years later, part of the gain is inflation, not a real return. Providing a lower rate offsets this investment-killing "inflation tax."

Double taxation is yet another concern. If expected corporate profits rise, share prices increase, creating an individual capital gain. But those future profits will also be taxed at the corporate level. If the combined rate of those two taxes is high, companies will slash investment. They will also load up on debt since it is not double-taxed, and that will destabilize the economy.

A capital gains tax increase would harm investment in start-up and growth companies. The reward that angel investors receive for putting their time and money into startups is a capital gain five or more years down the road. Raising capital gains taxes would prompt angels to shift their money to safer investments, starving the economy of fuel for dynamic industries such as technology.

Tax increases would reduce entrepreneurship. People considering launching startups would instead take safer wage jobs because the chance to earn a capital gain from a high-growth startup would not be worth all the extra stress, risk and hard work.

If Democrats follow through on their tax increases, money will flow out of technology clusters such as Silicon Valley. Such clusters have prospered as the cash generated from public offerings and buy-outs of successful growing firms has been reinvested in new rounds of startups. Higher taxes would rob the economy of this wealth that is recycled into new ventures.

Various breaks allow technology investors to escape or defer capital gains taxes when they exit successful investments. Tech industry leaders perhaps assume that they will retain these breaks even if Biden pushes up overall tax rates. But that is a risky assumption given how far left the Democratic Party has moved on economic policy.

Another loser if Biden wins and raises tax rates: state governments. The states compete against the federal government over tax bases. Capital gains taxes generate a large behavior response, so if Biden hikes the federal rate then both the federal and state tax bases would shrink. State tax revenues in states such as California and New York that depend on capital gains will fall. Thus, Biden's capital gains tax hike would not only damage Silicon Valley and Manhattan's Silicon Alley, but also Sacramento and Albany.

If Biden wins the election, leaders in both Alleys and other technology clusters would be smart to lobby the incoming administration to change course. In California and New York, the combined federal-state top capital gains tax rate would be pushed up to around 50 percent. How many high-tech entrepreneurs and angels will put their time, effort and money into illiquid and risky startup investments if — in the 1-in-10 chance they hit it big — governments take half the return?

A capital gains tax hike would damage U.S. technology businesses for no good reason and reduce state tax revenues. As Biden might say, “come on man,” that makes no sense.

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