Why a Capital Gains Tax Increase Would Be a Massive Jobs (and Wealth) Killer

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Aadi Golchha

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When discussing the economic growth of a post-COVID landscape, too often the role of angel investors is overlooked. Angel investors, or private investors who are often wealthy, finance small business ventures in exchange for equity. For small businesses, angel investors provide a much needed lifeline in the form of cash infusion that doesn't have to be repaid, except in shared ownership. Private investment, most often through angel investors, is undoubtedly a driving force in technological advancement and job creation.

Unfortunately, angel investment has recently been threatened by the looming possibility of capital gains tax increases under the new administration. Long-term capital gains taxes are applied to assets, such as equity in business, owned for over a year when sold. As of now, long-term capital gains are taxed at 20 percent for wealthy investors. The White House is now calling for a 39.6% top federal tax rate, nearly double the current amount.

As Chris Edwards, director of tax policy studies at Downsizing Government, explains, "In biotechnology and other leading-edge industries, after-tax investor gains are often reinvested in the next round of risky startups, thus creating a virtuous cycle."

One of the reasons that nearly all high-income countries keep capital-gains taxes low is to help ensure that investors and entrepreneurs are incentivized to take the risk of committing time and resources to relatively risky start-up ventures, typically reliant on the type of scientific and technical innovation that fuels job growth and progress in the long run.

According to Census Bureau data, although startups comprise less than one percent of all companies, they generate 10 percent of new jobs in any given year. The Kauffman Foundation's Tim Kane pointed out that "without startups, there would be no net job growth in the U.S. economy." In the same paper, he lays out the argument that "in terms of the life cycle of job growth, policymakers should appreciate the tremendous effect of job creation in the first year of a firm's life."

Wealthy angel investors have been behind many US corporations that have revolutionized their field and led to unprecedented growth and technological progress. Henry Ford, for example, received an infusion of cash from coal dealer Alexander Y. Malcolmson. The first investor in Apple was a millionaire retiree from Intel, Mike Markkula. Jeff Bezos obtained $8 million from Kleiner Perkins to build Amazon.

An increase in capital gains taxes would discourage such high-risk investments that provide much-needed seed money to startups, and induce investors to shift their investments to dividend-paying stocks or bonds. While safer, these avenues of investment do not produce the jobs or innovation that startups do, and would hinder entrepreneurship.

"Such tax increases would be a blow to startup investment and entrepreneurship," Edwards writes. "People considering launching technology startups would instead stay in salaried jobs because earning a smaller after-tax gain from a startup would not be worth all the extra stress, risk, and hard work."

This tax increase would also make it harder for startups to attract skilled workers. Three-quarters of Silicon Valley firms offer stock options to employees to lure them away from their salaried positions at large companies. A significantly higher capital gains tax would make that benefit much less appealing.

A capital gains tax increase would come as a huge blow to angel investors who fund the new technologies and ideas that we often take for granted. To ensure future growth and progress, it is imperative that we create and maintain an environment that allows angel investors to operate and thrive.