



Executive Summary

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The Wrong Answer for Oregon's Economy: Cutting Taxes on Capital Gains Income

By Jeff Thompson

Oregon's slow-growing recovery has prompted policy makers to pursue efforts to stimulate the economy. Despite claims by the Oregon Council on Knowledge and Economic Development (OCKED) and the Oregon Business Council (OBC), economic research suggests that cutting the capital gains tax is not likely to generate significant jobs or investment in Oregon:

Capital gains tax cuts have little impact on the cost of capital and little influence on investment and savings decisions. Half of capital gains income is already exempt. Most taxable gains are already realized annually, even without a tax cut, or held for bequests. Capital gains taxes influence the timing of asset sales, not fundamental investment decisions.

State-level tax cuts have an especially small impact. Windfall gains from a tax cut that are spent or re-invested in other states do nothing to benefit Oregon. If revenue losses from a tax cut are not offset by other tax increases, vital public services will have to be reduced. Increased federal taxes and lost federal matching funds, triggered by a state tax cut and related spending cuts, would have a larger economic impact than the tax cut itself.

Oregon's tax on capital gains income has not harmed the economy. Oregon's economy grew faster than nearly every other state in the 1990s, with 30,000 new businesses and 415,000 jobs. Oregon's economy declined steeply in 2001 because the national economy declined, and Oregon had become dependent on a volatile high-tech industry. Since 2001, Oregon's economy has been recovering, growing faster than most other states.

Low capital gains taxes are not necessary to attract venture capital. California has a higher capital gains tax rate than Oregon, but is home to the largest venture capital community in the world, consistently receiving 40 percent of all US venture capital investment. The *New Economy Index* shows that Oregon is among the top ten states for venture capital, and an Oregon Progress Board study written for the OBC shows Oregon ranks "favorably" among states for venture capital. Only 12 percent of venture capital is from sources subject to the capital gains tax. Previous efforts to spur investment through capital gains tax incentives have failed.

Capital gains income already receives considerable preferential tax treatment. The top federal tax rate on capital gains held more than one year is just 20 percent, compared to 38.6 percent on regular income. Half of capital gains from the sale of "small" businesses, with assets under \$50 million, are exempt from federal taxes, and federal taxes on gains reinvested in other small businesses are deferred entirely.

Capital gains tax cuts overwhelmingly benefit those with very high incomes. Most households own no assets that generate *taxable* capital gains. Most of the rest own little. The richest 5 percent of Oregonians would receive about 73 percent of a capital gains tax cut, while the lowest-income 80 percent would get about 9 percent.