

## The Four Flaws of a Capital Gains Income Tax Cut

### *It creates favoritism, it's ineffective, it's unnecessary and it's irresponsible*

It's unfortunate that some Oregon lawmakers are pushing to cut the tax rate on income from capital gains. Several legislative proposals exist to grant preferential treatment to income generated from the sale of assets such as stocks, bonds and real estate. This misguided policy fails on four fundamental levels: it favors some taxpayers over others, it's ineffective, it's unnecessary and it's irresponsible.

Cutting the income tax on capital gains favors speculators over workers and favors the rich over the rest. It would create a situation where ordinary Oregonians working for paychecks would end up paying a higher tax rate on their income than someone who lives off of investment income. For example, the average salary for a teacher in Oregon in 2010 was about \$51,000. An educator earning this amount in 2012 would pay a top rate of 9 percent in income taxes. If that year the tax rate on capital gains income were cut in half, someone who is fortunate enough to live off of investment or trust fund income — be it the same amount as the teacher earns or many times that amount — would pay a top rate of no more than 4.95 percent.

It would also, by and large, constitute a tax cut just for the rich. If Oregon halved the income tax rate on capital gains, the richest 1 percent of Oregonians would get 65 percent of the tax cut. The rest of Oregonians would receive little or nothing.

Cutting the income tax on capital gains is also ineffective as a means to attract investment, contrary to what proponents claim. Research shows that there is no correlation between growth in the economy — real GDP growth — and the tax rate on income from capital gains. Demand for products and services, not the amount of after tax income, is what drives investment. Thus, a general tax cut on income from capital gains will have no real impact on investment. Plus, there's no guarantee that the money would be reinvested in Oregon. And for those who argue for a targeted tax cut for money reinvested in the state, Oregon's own experience demonstrates the futility of such an effort.

Cutting the income tax on capital gains is also unnecessary, since Oregon's economy already tends to outperform the nation as a whole. In recent years, Oregon's economy has grown faster than that of the nation and has attracted more than its share of venture capital, even though, like a majority of states with income taxes, it taxes income from capital gains the same as any other income. Indeed, more taxpayers with capital gains income move to Oregon than move out, and collectively, in the year of their moves, those arriving have more capital gains than those who leave Oregon.

Finally, cutting the income tax on capital gains is irresponsible. During difficult economic times, income from capital gains constitutes an important source of revenue to fund popular and vital public services. During good economic times the income tax on capital gains shines, often generating more revenue than anticipated. If this unanticipated revenue were saved in the Rainy Day Fund, Oregon would be better positioned to weather bad economic times. By giving preferential tax treatment to income from capital gains, the income tax would not shine so brightly in good years, harming Oregon's ability both to fund vital and popular public services and to save for rainy days.

## The Four Flaws of a Capital Gains Income Tax Cut

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By Jason Gettel

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Cutting the income tax on capital gains is also ineffective as a means to attract investment, contrary to what proponents claim. Demand for products and services, not the amount of after-tax income, is what drives investment. Thus, a general tax cut on income from capital gains will have no real impact on investment. Plus, there's no guarantee that the money would be reinvested in Oregon. And for those who argue for a targeted tax cut for money reinvested in the state, Oregon's own experience demonstrates the futility of such an effort.

Cutting the income tax on capital gains is also unnecessary, since Oregon's economy already tends to outperform the nation as a whole. In recent years, Oregon's economy has grown faster than that of the nation and has attracted more than its share of venture capital, even though, like a majority of states with income taxes, it taxes income from capital gains the same as any other income. Indeed, more taxpayers with capital gains income move to Oregon than move out, and collectively, in the year of their moves, those arriving have more capital gains than those who leave Oregon.

Finally, cutting the income tax on capital gains is irresponsible. During good economic times the income tax on capital gains shines, often generating more revenue than anticipated. If this unanticipated revenue were saved in the Rainy Day Fund, Oregon would be better-positioned to weather bad economic times. By giving preferential tax treatment to income from capital gains, the income tax would not shine so brightly in good years, harming Oregon's ability both to fund vital and popular public services and to save for rainy days.

### **Favoritism: Tax cut would favor speculators over workers, the rich over the rest**

Granting preferential tax treatment to capital gains income would benefit speculators at the expense of workers; it would benefit the rich over all other Oregonians; and it would harm the public structures that nurture the middle class.

### ***It would benefit speculators at expense of workers***

The state tax structure should not penalize Oregonians who work for a paycheck in favor of those who live off of investments. Yet, that is what would happen if the legislature reduces the income tax on capital gains.

Consider what happens to working Oregonians by giving special treatment to income from capital gains. The average salary for a teacher in Oregon in 2010 was about \$51,000.<sup>1</sup> An educator earning this amount in 2012 would pay a top rate of 9 percent in income taxes. If that year the tax rate on capital gains income were cut in half, someone who is fortunate enough to live off of investment or trust fund income — be it the same amount as the teacher earns or many times that amount — would pay a top rate of no more than 4.95 percent.<sup>2</sup>

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The special treatment for those with investment income constitutes a “working tax penalty,” according to former Vermont Governor Jim Douglas (R). Calling for the elimination of Vermont’s preferential treatment of income from capital gains, Governor Douglas said in 2008:

Our current tax structure taxes earned income — that is, your hourly wage or salary — at a higher rate than it taxes unearned income. What this means is that a working man or woman in Vermont making \$50,000 a year pays nearly 50 percent more tax than someone who does not work and simply lives off investment or trust fund capital gains income in the same amount. Our state is one of only a few that has such an unfair penalty for doing an honest day’s work. This is grossly unfair. We must close this loophole and eliminate this working tax penalty.<sup>3</sup>

Indeed, most states — Oregon included — treat income from paychecks the same as income from investments. Forty-two states, counting the District of Columbia as a state, levy a broad-based personal income tax. Only nine of them give significant preferential treatment for income from capital gains over income from work.<sup>4</sup>

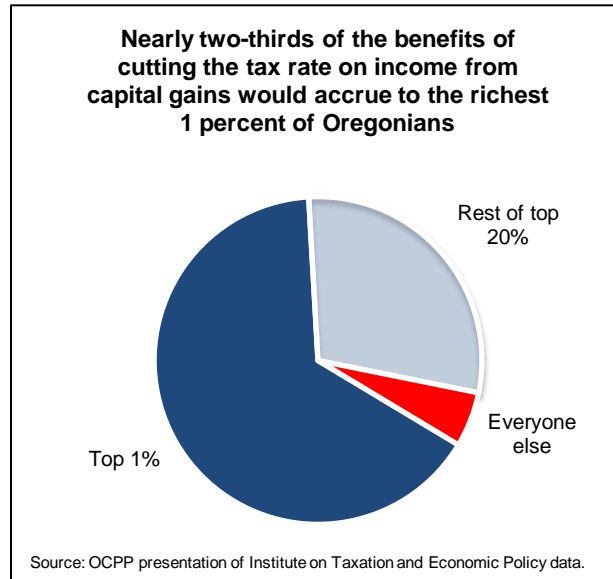
Treating workers and speculators the same is good economic development policy. Rhode Island recently eliminated preferential treatment for capital gains as part of an economic development strategy to gain competitive advantage in job retention and business recruitment. In 2008, a commission charged with “developing a tax strategy so that Rhode Island’s tax structure is a competitive advantage in retaining jobs and recruiting businesses” recommended treating income from capital gains the same rate as income from work.<sup>5</sup> The 2009 Rhode Island General Assembly agreed and enacted legislation to tax all capital gains income at the same rate as ordinary income beginning January 1, 2010.<sup>6</sup>

Giving special treatment to income from capital gains would penalize an honest day’s work and put Oregon’s tax system at odds with a majority of other states.

### ***It would benefit the rich at expense of all other Oregonians***

Cutting the tax on income from capital gains would be a boon for rich Oregonians, with everyone else receiving little or nothing. With the income gap between the rich and the rest already at extreme levels, cutting the income tax on capital gains would further unbalance Oregon’s economy.

Because the rich disproportionately own capital assets (stocks, bonds and real estate), capital gains — the income from the sale of those assets — mostly flow to the top. In 2009, over half of Oregon’s net capital gains income (54 percent) went to those making over \$500,000 per year. Those making more than half-a-million dollars per year made up fewer than 1 in 300 taxpayers.<sup>7</sup> For this wealthiest group as a whole, 18 out of every 100 dollars in income came from capital gains, compared to only 1 out of every 100 dollars for all other Oregonians making less than \$500,000 a year, combined.<sup>8</sup>

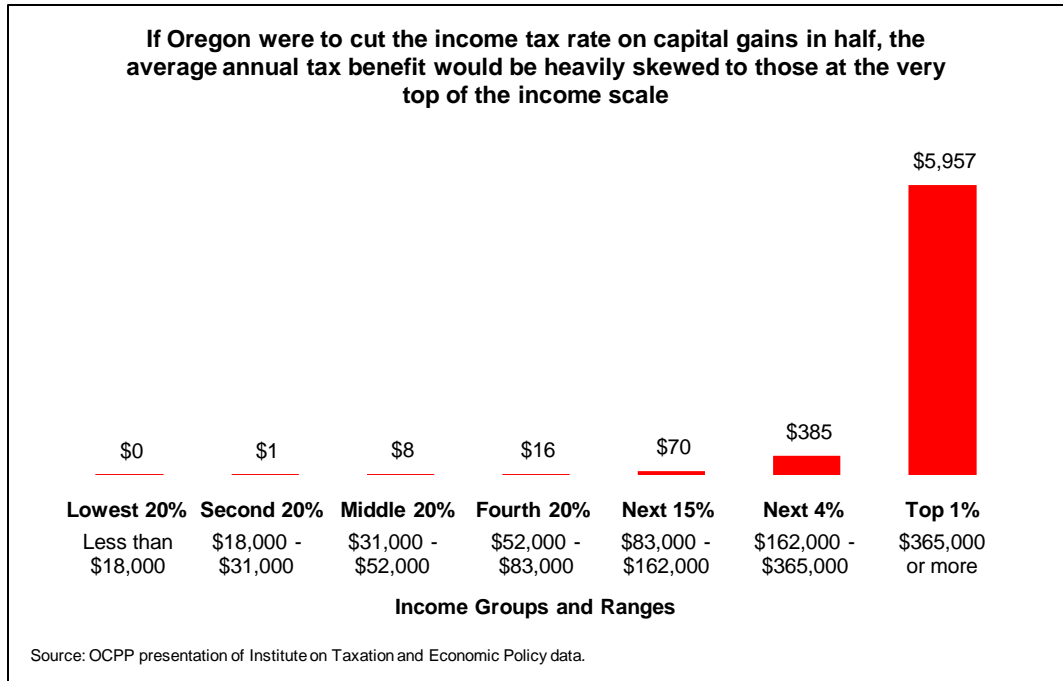


Thus, reducing the tax rate on income from capital gains would by-and-large constitute a tax cut for the rich. If Oregon halved the income tax rate on capital gains, the richest 1 percent of Oregonians would get 65 percent of the tax cut.<sup>9</sup> Among all people in this elite group, the average tax savings would be almost \$6,000 per year. The average tax cut for those in the top 1 percent that actually receive a cut would be over \$9,000 per year.<sup>10</sup>

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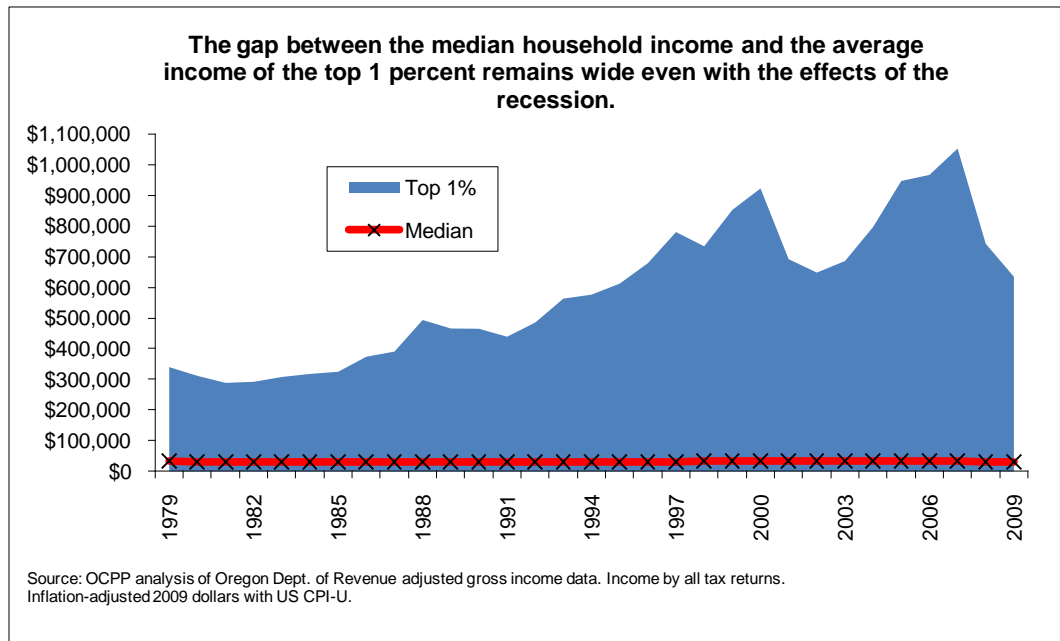
By contrast, very little of the benefits would accrue to the remaining 99 percent of Oregonians. Four-fifths of all Oregonians —all but the wealthiest 20 percent — would only get to split among them 5 percent of the total benefits of cutting the tax rate on income from capital gains in half.<sup>11</sup> Even taxpayers with incomes between \$83,000 and \$162,000 — who earn well above what the middle-income Oregonian makes — would, on average, see a tax savings of only \$70.<sup>12</sup>

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Only 9 out of every 100 Oregon taxpayers would see a reduction in their income taxes if the tax rate on capital gains income were cut in half.

Apart from the skewed distribution of the tax benefits to the top income group, the majority of Oregon taxpayers would not benefit at all from a cut to the income tax rate on capital gains because they do not own assets that are subject to capital gains taxation. Only 9 out of every 100 Oregon taxpayers would see a reduction in their income taxes if the tax rate on capital gains income were cut in half.<sup>13</sup>



With only rich Oregonians benefiting significantly from it and all others getting little or no benefit, granting preferential treatment to capital gains would tend to exacerbate income inequality. Over the past three decades, the typical household in

Oregon has endured income stagnation, while the wealthiest 1 percent have seen their income soar. Oregon median household income in 2009 (\$30,327) was 9.8 percent lower than it was in 1979 (\$33,618), after adjusting for inflation.<sup>14</sup> By contrast, the average inflation-adjusted income among the wealthiest 1 percent in Oregon has almost doubled from \$340,092 in 1979 to \$634,902 in 2009.<sup>15</sup> Thus, cutting the tax rate on income from capital gains would largely benefit the relatively few who, by-and-large, captured the income gains of the past three decades.

***It would give the rich a tax cut on top of the one they are already slated to get***

When the 2009 legislature adopted what became Measure 66, enacted by voters in January 2010, lawmakers relied on economic forecasts that predicted a less severe recession and a faster and stronger recovery than what has transpired.<sup>16</sup> At that time, the legislature expected that revenue for the 2011-13 biennium would be almost \$2 billion more than what the Office of Economic Analysis now predicts.<sup>17</sup> Lawmakers assumed — incorrectly, it turned out — that the state could afford to reduce the top rates for the wealthiest Oregonians starting in January 2012.

Thus, they wrote a tax cut into the law. On January 1, 2012, the top marginal tax rates of 11 percent for income for couples in excess of \$500,000 and 10.8 percent for income between \$250,000 and \$500,000 will fall to 9.9 percent. The Legislative Revenue Office predicts that this scheduled tax cut for the 4 percent of Oregon households with income of \$250,000 or more will cost the state budget \$134 million in the next two year budget period, and \$247 million in the 2013-15 budget period when income from capital gains are expected to have rebounded to pre-recession levels.<sup>18</sup>

This scheduled tax cut for the 4 percent of Oregon households with income of \$250,000 or more will cost the state budget \$134 million in the next two year budget period.

Because Oregon currently treats all income equally and the bulk of capital gains income flows to Oregon's wealthiest households subject to the Measure 66 rates, the scheduled tax cut already lowers the tax on income from capital gains for the wealthiest Oregonians. Granting capital gains income special tax treatment would pile more benefits on top of the scheduled tax cut that the wealthy are slated to get.

***It would harm the public structures that nurture the middle class and protect the vulnerable***

Cutting the income tax on capital gains would, of course, result in less revenue for the state. That would mean fewer resources for schools, health and human services and public safety — the public structures that nurture the middle class and protect the vulnerable.

For example, cutting the income tax rate on capital gains to 5 percent would mean a loss of at least \$165 million in a single year.<sup>19</sup> Over the course of the 2011-13 budget cycle, the cost would be about \$338 million,<sup>20</sup> which would be almost enough to fund a key component of Governor Kitzhaber's plan to focus on early childhood education. The Governor recommended that the Early Learning Council, designed to ensure children enter school ready to learn, receive \$361 million from the General Fund in the *2011-13 Governor's Balanced Budget*.<sup>21</sup>

In addition to direct revenue loss, Oregon's economy would likely lose federal funding. Many state programs, particularly health care for the poor, aged and disabled, receive federal matching funds. If the legislature were to make up the lost

revenue by cutting these vital services, the amount of federal funds flowing into the state would also be reduced. For example, each dollar of reduced state spending in Medicaid results in about \$2 in lost federal matching funds that flow to health care sectors of the economy.

### **Ineffective: Tax cut would fail to attract investment**

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Proponents of cutting the income tax on capital gains argue that the special treatment is necessary to attract investment, which in turn will stimulate economic growth and create jobs.<sup>22</sup> This oft-repeated claim doesn't stand up to scrutiny.

Most careful and independent research suggests that effects of capital gains tax cuts on investment and employment are minimal at best. "Capital gains rates display no contemporaneous correlation with real GDP growth during the last 50 years," according to Leonard Burman, the Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School of Syracuse University and one of the nation's leading experts on capital gains taxation.<sup>23</sup> This is, in part, because significant business investment comes from sources such as pension funds and insurances companies unaffected by capital gains, making the tax rate on capital gains income irrelevant.<sup>24</sup> Likewise, the non-partisan Congressional Budget Office found that increasing after-tax income "typically does not create much incentive ... to hire more workers in order to produce more, because production depends principally on [businesses'] ability to sell their products."<sup>25</sup>

**Demand for products and services creates jobs — not tax breaks for the rich.**

In other words, demand for products and services creates jobs — not tax breaks for the rich.

The futility of cutting the income tax on capital gains is all the more apparent at the state level. If Oregon were to enact such a tax cut, there is no guarantee that the tax savings reaped by its beneficiaries — largely the richest Oregonians — would be reinvested in Oregon. Capital being highly mobile, those tax savings could just as easily be reinvested with a Wall Street hedge fund or invested in the Shanghai stock market.

While some would argue that Oregon could offer a more targeted tax cut to income reinvested in Oregon, the state's own experience demonstrates the futility of such an effort. In the mid 1990s, Oregon experimented with a program that allowed certain investors, primarily investors in start-up companies, to defer Oregon income taxes on capital gains if the gains were reinvested in Oregon businesses. In a joint report, the Legislative Revenue Office, the Oregon Department of Revenue and the Oregon Department of Economic and Community Development (now Business Oregon) concluded that the program was a failure.<sup>26</sup>

The report found that the program "has not achieved [its] goal," which was to increase investment in Oregon. It further stated, "Given the small amount of investment under Oregon's deferral program in its first two years, and because much of that investment probably would have occurred even without the deferral, the program has created few, if any, new jobs."<sup>27</sup>

**Unnecessary: with its current tax rate Oregon does well relative to the nation**

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In an effort to justify a lower tax rate on capital gains income, proponents paint an ugly picture of Oregon's economy. They claim that Oregon performs badly when compared to other states and that its tax structure drives away wealthy Oregonians.<sup>28</sup> Again, their arguments don't stand up to scrutiny.

***Oregon already outpaces the nation in economic growth and in inflow of venture capital***

During the last decade, Oregon's economy far outperformed that of the nation as a whole.

Despite experiencing two recessions, Oregon Gross Domestic Product grew 31 percent from 2000 to 2009 in inflation-adjusted terms, faster than the 14 percent gain experienced nationally.<sup>29</sup> That success happened without giving special treatment to speculators and the rich.

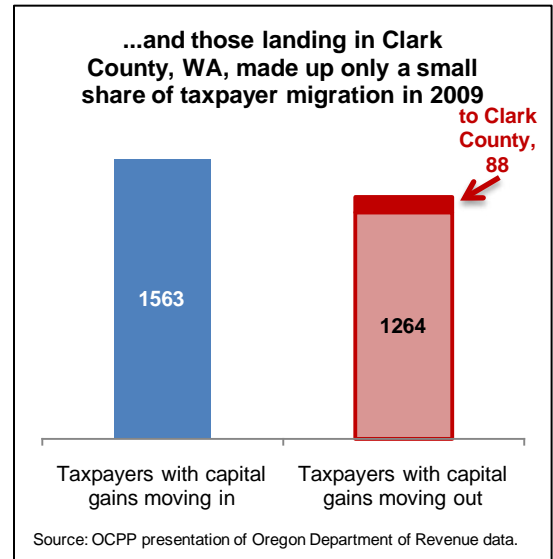
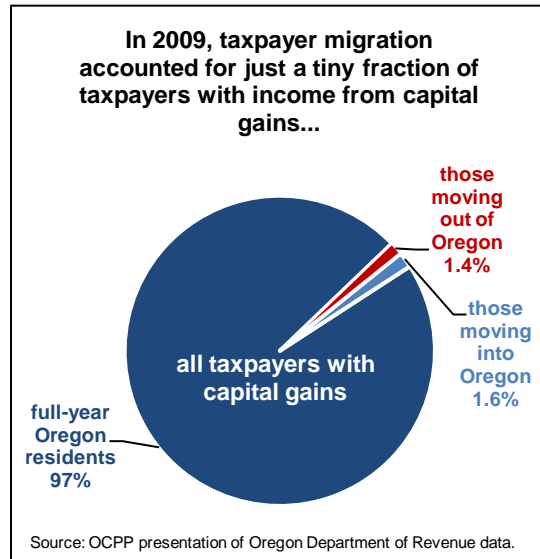
Venture capital investment in Oregon has also been stellar. Oregon's venture capital investment rose from \$91 million in 2009 to \$196 million in 2010. That amounts to a 115 percent growth rate, far above the increase nationwide of 20 percent. On a per capita basis, Oregon's venture capital ranked 15th highest among all states and the District of Columbia in 2010. That was better than its per capita rank in 2009 (22nd) and better than the average per capita rank of 18th over the previous 15-year period, from 1995 through 2009.<sup>30</sup>

***People with capital gains income are migrating to Oregon***

Among taxpayers with capital gains income who move to and from Oregon, more moved to Oregon than moved out — as evidenced in the most recent 10-year period with available data. And in the year of their moves, those arriving, collectively, had more capital gains than those leaving Oregon. In other words, over those 10 years Oregon had a net inflow of capital gains income.

Among taxpayers with capital gains income who move to and from Oregon, more moved to Oregon than moved out.

Analysis of Oregon Department of Revenue data reveals that net inflow. From 2000 to 2009, an average of 3,269 taxpayers reporting \$120 million in capital gains income moved out of Oregon each year.<sup>31</sup> During the same time period, an average of 4,357 taxpayers with capital gains income moved *into* Oregon, bringing with them \$144 million in capital gains income that year.<sup>32</sup> Thus, each year Oregon had an average net inflow of \$24 million in capital gains income.<sup>33</sup> In fact, in all but one of those 10 years (2000), people moving into Oregon have had more income from capital gains during the year of their move than those moving out of Oregon.



The fact that Oregon’s tax structure is not chasing away taxpayers with capital gain income is evident even in the data concerning Clark County, Washington. Critics of Oregon’s tax structure suggest that there is a flood of Oregon taxpayers migrating to Clark County, Washington, to avoid income taxes, including the income tax on capital gains.<sup>34</sup> While stories circulate of wealthy Oregonians moving to Clark County to avoid taxes, anecdotes do not amount to reliable evidence. The data show that, at most, the migration is minimal. Oregon had an average of about 190,000 full-year residents with capital gains income each year between 2000 and 2009. And of that group, on average only 14 of every 10,000 (0.14 percent) moved to Clark County. Among all 1.7 million Oregon taxpayers — those with and without income from capital gains — an average of just 2 of every 10,000 (0.02 percent) had income from capital gains and moved to Clark County each year from 2000-09.<sup>35</sup>

Out of nearly 1.8 million total returns, 97,000 reported income from capital gains. Of those, only 88 taxpayers with income from capital gains moved to Clark County.

The data from 2009 further illustrates the negligible effect of Oregon’s tax structure. That year, out of nearly 1.8 million total returns, 97,000 reported income from capital gains. Of those, only 88 taxpayers with income from capital gains moved to Clark County.<sup>36</sup>

Of course, those who packed their belongings and moved across the river may have done so for reasons other than taxes — for example, cheaper housing, job availability and family-related reasons. But whatever the reason for their move, the fact that just 88 taxpayers with capital gains income, out of Oregon’s 1.8 million taxpayers, relocated to Clark County is not grounds to grant preferential treatment that would primarily benefit Oregon’s richest households.

***Investments and jobs stay in Oregon***

Even if Oregonians move to Clark County before realizing large capital gains, Oregon does not necessarily lose all of their investment capital as a result. Those who have made money in Oregon may continue investing in Oregon in the future, even if they move a few miles away. Moreover, while Oregon may lose tax revenue because some of the capital gains income of those living outside of Oregon will not be taxed as income here, Oregon does not lose the economic growth or potential jobs created by businesses located here simply because the owner lives in another state.

In fact, just because someone lives in Clark County it doesn't mean they don't work in Oregon and continue to pay Oregon income taxes. In 2009, about one-third of Clark County's resident workforce (roughly 56,000 individuals), some of whom are quite rich, filed Oregon income tax returns. These Clark County filers reported a total adjusted gross income of \$2.2 billion in 2009, including \$5.4 million in income from capital gains.<sup>37</sup> The percent of Clark County residents filing Oregon income tax returns who made over \$500,000 in 2009 was 0.2 percent, not much different than the 0.3 percent of full-year Oregon residents who made that much money.<sup>38</sup>

***Across the nation, people don't migrate because of tax policy***

The conclusion that Oregon's tax structure is, at worst, causing a miniscule number of Oregonians to relocate to Clark County is entirely consistent with the findings of studies of the impact of state taxes on migration.

"The consensus emerging from the migration literature — and from a range of research designs — is that people do not generally migrate in response to tax increases (or to tax differentials that would be 'easy' to arbitrage)," according to a recent study by Princeton researchers published in the *National Tax Journal*.<sup>39</sup> That study found that the migration effect of New Jersey's so-called "millionaire tax" — a tax bracket for taxpayers with income above \$500,000 enacted in 2004 — was "close to zero."<sup>40</sup>

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Likewise, a scholar at the University of Massachusetts, Amherst recently conducted a study of migration among the New England states. It concluded that "taxes do not play any notable role in causing people to leave a state."<sup>41</sup>

**Irresponsible: Granting special treatment to rich would make it harder to fund popular and vital services and save for a rainy day**

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The revenue collapse that followed the onset of the Great Recession demonstrated yet again the need for Oregon to build up its revenue reserves. By saving during the good economic times, Oregon would be in a better position to weather the inevitable economic downturns. Cutting the income tax on capital gains, however, would weaken the best source of revenue for building up Oregon's reserves.

When the economy performs well, Oregon's tax system — led by the income tax on capital gains — tends to bring in more funds than anticipated. That certainly was the case in the 2005-07 budget cycle, the last time that revenue surged beyond expectations, causing the "kicker" to kick.<sup>42</sup> In that instance, income from capital gains accounted for one out of every 11 dollars of income reported in Oregon.<sup>43</sup> In tax year 2005, one of the years contributing to the unanticipated revenue that resulted in

a kicker, income from capital gains increased by 59 percent and accounted for over a third of the growth in the adjusted gross income of full-year residents.<sup>44</sup>

That Oregon's revenues surge during good times from the income tax on capital gains is a good thing. To the extent a surge is anticipated, the funds can support vital public services that otherwise would need to be funded from the income tax on paychecks. To the extent a surge is unanticipated, the unexpected revenue can be saved in the Rainy Day Fund, putting Oregon in a better position to weather bad economic times.

Even during difficult economic times, income from capital gains constitutes an important source of revenue to fund popular and vital public services such as schools, the courts, health care and care for the elderly.

Even during difficult economic times, income from capital gains constitutes an important source of revenue to fund popular and vital public services such as schools, the courts, health care and care for the elderly. Following the pummeling of the stock market at the beginning of the Great Recession, full-year Oregon residents still reported \$3.8 billion in capital gains in 2008 and \$2 billion in 2009.<sup>45</sup> This amounted to 4.5 percent of total income in 2008 and 2.5 percent in 2009. The tax on this income from investment funds vital public services during the difficult times.

Thus, whether enacted during good or bad economic times, cutting the tax rate on the income from capital gains is irresponsible state fiscal policy.

### **Conclusion**

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Any proposal to cut the income tax on capital gains fails on four fundamental levels: it would create a tax system that favors speculators over workers and the rich over all other Oregonians; it would be ineffective as a means of attracting investment into the state; it's unnecessary because with its current tax rate on capital gains, Oregon compares favorably to the rest of the nation; and it's fiscally irresponsible in view of the need to strengthen Oregon's reserves and fund vital public services during good and bad economic times.

## Endnotes

<sup>1</sup> Oregon Employment Department, Occupational Information Center, available at <http://www.qualityinfo.org/olmisj/OIC>.

<sup>2</sup> In 2012, the upper-most income tax rate is scheduled to be 9.9 percent. Cutting the rate in half for income from capital gains would result in a top rate of 4.95 percent on income from capital gains.

<sup>3</sup> Governor James H. Douglas, Vermont State of the State Address, January 10, 2008, available at <http://www.stateline.org/live/details/speech?contentId=271445>. Prior to 2009, Vermont taxpayers were allowed to exclude 40 percent of their income from capital gains and the remainder was treated as regular taxable income. Vermont's 2009 legislature greatly reduced the exemption. However, the 2010 legislature reversed course and, effective January 1, 2011, restored the 40 percent exclusion to some, but not all, types of capital gains income. While the exemption remains more narrowly defined than it was prior to the changes made in 2009, as indicated in endnote 4, Vermont is back in the minority of states with significant special treatment of capital gains.

<sup>4</sup> Thirty-three states, including the District of Columbia as a state, either give no preferential treatment of income from capital gains, or only narrowly defined preferential treatment. Typically, any limited preferential treatment is only available for capital gains on specified in-state investments. For example, Utah offers a deduction for gains used to purchase qualifying stock in a Utah small business corporation. Oregon taxes gains from the sale of certain farm assets at a reduced rate. Of the 9 states with broad-based income taxes that provide preferential treatment to capital gains income, four (Hawaii, North Dakota, South Carolina and Wisconsin) provide special treatment to income from long-term capital gains. The other five (Arkansas, Iowa, Montana, New Mexico and Vermont) offer significant special treatment of at least some forms of both short- and long-term capital gains. See Institute on Taxation and Economic Policy (ITEP), *The ITEP Guide to Fair State and Local Taxes*, Chapter 5 Appendix, 2011, available at [http://itepnet.org/state\\_reports/guide2011.php](http://itepnet.org/state_reports/guide2011.php) and ITEP, *A Capital Idea: Repealing State Tax Breaks for Capital Gains Would Ease Budget Woes and Improve Tax Fairness*, January 2011, available at [http://www.itepnet.org/pdf/A\\_Capital\\_Idea.pdf](http://www.itepnet.org/pdf/A_Capital_Idea.pdf).

<sup>5</sup> State of Rhode Island and Providence Plantations, *Report of the Governor's Tax Policy Strategy Workgroup*, March 6, 2009, p. 3, available at <http://www.dor.ri.gov/Workgroup%20Meetings/Tax%20Report%20Final%203-6-09.pdf>

<sup>6</sup> State of Rhode Island and Providence Plantations, Department of Revenue, Office of Revenue Analysis, *Rhode Island Revenue Changes*, 2009 Session, pp. 1-3, available at <http://www.dor.ri.gov/Reports/RI%20Revenue%20Changes%202009%20Session.pdf>.

<sup>7</sup> OCPP analysis of Oregon Department of Revenue (DOR) data.

<sup>8</sup> OCPP analysis of DOR data.

<sup>9</sup> Estimate of the impact of reducing Oregon's income tax rates on capital gains by 50 percent or fully exempting capital gains from personal income tax prepared by ITEP for OCPP, March 2011 (hereafter ITEP estimate). This analysis is based on assuming the permanent upper income tax rate of 9.9 percent that is scheduled to take effect in 2012 but uses 2011 estimated income levels because of increased accuracy.

<sup>10</sup> ITEP estimate.

<sup>11</sup> ITEP estimate.

<sup>12</sup> ITEP estimate. Not everyone in this income group will realize a tax savings. Among those who will see a reduction in their taxes, the average savings will be \$295.

<sup>13</sup> ITEP estimate.

<sup>14</sup> OCPP analysis of DOR data.

<sup>15</sup> OCPP analysis of DOR data.

<sup>16</sup> For an illustration of the difference in employment forecasts, see Office of Economic Analysis, *Economic and Revenue Forecast*, March 2011, presentation to House & Senate Revenue Committees, February 15, 2011, slide 12, available at [http://www.oregon.gov/DAS/OEA/revenue.shtml#Other\\_Reports\\_and\\_Statistics](http://www.oregon.gov/DAS/OEA/revenue.shtml#Other_Reports_and_Statistics).

<sup>17</sup> Calculated from 2011-13 General Fund revenue in May 2009 *Economic and Revenue Forecast* (\$15 billion) adjusted using the September close of session forecast to \$15.8 billion. 2011-13 General Fund revenues are predicted to be \$13.9 billion in the May 2011 *Economic and Revenue Forecast*. Office of Economic Analysis, *Economic and Revenue Forecast*, May 2009, September 2009 and May 2011.

<sup>18</sup> Allanach, Christopher, e-mail to Charles Sheketoff, March 17, 2011.

<sup>19</sup> Legislative Revenue Office (LRO) estimates the cost of reducing the income tax rate on capital gains to 5 percent to be \$164.9 million for the 2011-12 fiscal year, \$172.6 million in fiscal year 2012-13, \$191.7 million in fiscal year 2013-14 and \$197 million in fiscal year 2014-15. LRO, *2011 Oregon Public Finance: Basic Facts*, Research Report #1-11, available at [http://www.leg.state.or.us/comm/lro/2011\\_publications\\_reports/2011\\_BasicFacts.pdf](http://www.leg.state.or.us/comm/lro/2011_publications_reports/2011_BasicFacts.pdf).

<sup>20</sup> LRO, *2011 Basic Facts*. Also see note 19.

## The Four Flaws of a Capital Gains Income Tax Cut

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<sup>21</sup> State of Oregon, *2011-13 Governor's Balanced Budget*, p. B-9, available at [http://governor.oregon.gov/Gov/docs/priorities/BUDGET\\_Full\\_Budget.pdf](http://governor.oregon.gov/Gov/docs/priorities/BUDGET_Full_Budget.pdf).

<sup>22</sup> See the following examples: The Oregon Business Plan claims that a cut in the income tax on capital gains would help “spark economic growth and help us achieve our other goals of creating 25, 000 jobs per year and raising Oregon’s per capita income above the national average by 2020.” Memo to Governor John Kitzhaber from Oregon Business Plan Steering Committee, January 10, 2011, available at <http://www.oregonbusinessplan.org/LinkClick.aspx?fileticket=5GXbaxVuzuU%3d&tabid=146>. The project manager of the Oregon Business Plan wrote, “The individuals and investors who provide this capital and expertise are highly sensitive to income and capital gains tax rates, and Oregon’s highest-in-the-nation rates send these folks packing, or keep them away in the first place.” Jeremy Rogers, “The good, the bad and the ugly of Oregon taxes,” *The Oregonian*, April 26, 2011. Associated Oregon Industries, Oregon Business Association, Oregon Business Council and the Portland Business Alliance claim that a bill that would tie a tax cut on the income from capital gains to kicker reform would “spur job creation in Oregon.” News release, “Oregon business associations release top priorities for job creation: Organizations ask legislature to focus on job creation, getting people back to work,” May 10, 2011, available at <http://www.oba-online.org/wp/wp-content/uploads/2011/05/5.10.11-Jobs-bills-plus-list.pdf>. Oregon House Republican Leader Kevin Cameron reportedly stated, “The current rate serves as a barrier to economic development, and potentially drives companies and investors to other states where capital gains tax rates are lower or even zero. . . . A high capital gains tax rate — as we have in Oregon — discourages people from investing and encourages current investors to hold onto their assets. Reducing the rate will encourage investors to realize their gains, reinvest, and create jobs in Oregon.” See KZTV.com, “Ore. House GOP Moves to Slash Capital Gains: One Proposal Would Cut Tax in Half to Spur Investment,” March 12, 2011.

<sup>23</sup> Kravitz, Troy and Leonard Burman, Tax Policy Center, *Capital Gains Tax Rates, Stock Markets, and Growth*, November 7, 2005.

<sup>24</sup> See Burman, Len, memo to Chuck Sheketoff, Oregon Center for Public Policy, April 18, 2005, available at <http://www.ocpp.org/2005/memo050420nesbitt.pdf>; Leonard E. Burman, “End the Break On Capital Gains,” *The Washington Post*, July 30, 2007.

<sup>25</sup> Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011*, January 2011, p. 25, available at <http://www.cbo.gov/ftpdocs/108xx/doc10803/01-14-Employment.pdf>.

<sup>26</sup> Oregon Economic Development Department is now Business Oregon.

<sup>27</sup> Oregon Department of Revenue, Legislative Revenue Office and Oregon Economic Development Department, *Oregon's Capital Gains Deferral Program: An Evaluation of the First Two Years*, March 1999, p 1, available at [http://www.ocpp.org/blue/19990330\\_DOR\\_LRO\\_OEDD\\_Capital\\_Gains\\_Deferral\\_Program\\_Evaluation.pdf](http://www.ocpp.org/blue/19990330_DOR_LRO_OEDD_Capital_Gains_Deferral_Program_Evaluation.pdf).

<sup>28</sup> See examples in note 22.

<sup>29</sup> OCPP analysis of Bureau of Economic Analysis (BEA) data.

<sup>30</sup> OCPP analysis of data from the MoneyTree™ Report by PricewaterhouseCoopers and the National Venture Capital Association, based on data from Thomson Financial.

<sup>31</sup> OCPP analysis of DOR data.

<sup>32</sup> OCPP analysis of DOR data.

<sup>33</sup> OCPP analysis of DOR data.

<sup>34</sup> For example see Smith, Joe, “Activist says Oregonians moving to WA for tax relief”, KGW NewsChannel8, February 28, 2011, updated March 8, 2011, available at <http://www.kgw.com/news/local/Oregon-Tax-Payers-revolt-and-move-to-Washington-117114253.html> and Whelan, Robert and Alex Reed, ECONorthwest, *An Analysis of Average and Marginal Income Tax Rates in Oregon and Effects on Household Location*, June 2009, available at <http://www.oregonbusinessplan.org/LinkClick.aspx?fileticket=EbUBv-ZJFKw%3D&tabid=102>.

<sup>35</sup> OCPP analysis of DOR data.

<sup>36</sup> OCPP analysis of DOR data. The 88 taxpayers are those who moved from Oregon to Clark County and had capital gains income in the year of the move. We do not know the number taxpayers who moved to Oregon from Clark County who had capital gains income that same year. Thus we do not know the net migration between Oregon and Clark County. The 88 taxpayers represent just 0.005%, or five out of 100,000, Oregon taxpayers that year.

<sup>37</sup> DOR, *Oregon Personal Income Tax Annual Statistics, Tax Year 2009*, Results by County, Other States, and City, available at <http://www.oregon.gov/DOR/STATS/101-406-2011-toc.shtml>.

<sup>38</sup> OCPP analysis of DOR data.

<sup>39</sup> Young, Cristobal and Charles Varner, “Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment,” *National Tax Journal*, June 2011, p. 258, available at [http://www.stanford.edu/~cy10/public/Millionaire\\_Migration.pdf](http://www.stanford.edu/~cy10/public/Millionaire_Migration.pdf).

<sup>40</sup> Young and Varner, “Millionaire Migration and State Taxation of Top Incomes,” p. 267.

<sup>41</sup> Jeffrey Thompson, Political Economy Research Institute, *The Impact of Taxes on Migration in New England*, April 2011, p. 16.

<sup>42</sup> The automatic spending of revenue on a tax cut, popularly known as the “kicker,” goes into effect when revenue comes in at 2 percent or more than what state economists predicted two years earlier, at the close of session forecast.

<sup>43</sup> OCPP analysis of DOR data.

<sup>44</sup> DOR, *Oregon Personal Income Statistics Tax Year 2005*, p. 11, available at [http://www.oregon.gov/DOR/STATS/docs/101\\_406\\_07/101-406-07.pdf](http://www.oregon.gov/DOR/STATS/docs/101_406_07/101-406-07.pdf).

<sup>45</sup> DOR, *Oregon Personal Income Statistics Tax Year 2009*, p. 21, available at [http://www.oregon.gov/DOR/STATS/docs/101\\_406\\_11/101-406-11.pdf](http://www.oregon.gov/DOR/STATS/docs/101_406_11/101-406-11.pdf).

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