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OCPP Finds that Cutting Income Tax on Capital Gains Would Harm Nearly All Oregonians

With the state having begun a top-to-bottom review of its tax system, a report released today makes the case that cutting the existing income tax on capital gains — an idea often bandied about — would harm all but the wealthiest Oregonians.

The report, prepared by the Oregon Center for Public Policy, identified seven reasons why giving special treatment to income from capital gains is a “terrible idea.” It called the income tax on capital gains “the best player on the income tax team,” generating strong revenue for the state during good economic times and providing support during downturns.

“For us to get rid of the tax on capital gains income would be as calamitous as the Boston Red Sox’s trade of Babe Ruth to the Yankees,” said OCPP analyst Michael Leachman. “It would be an historic mistake and set Oregon on a path of mediocrity that we would be regretting for many years to come.”

Capital gains are profits on investments such as stocks, bonds and real estate. Currently, Oregon taxes income from capital gains at the same rate as all other forms of income.

“Some people take it as gospel truth that giving special tax treatment to income from capital gains will spur economic growth and employment, but there’s little evidence to support the claim,” said Leachman.

According to OCPP, analysis by the non-partisan Congressional Budget Office has found that cutting the tax rate for capital gains produces minimal economic growth — a conclusion buttressed by Oregon’s own experience. In the late 1990s, the state experimented with a program allowing investors in start-up companies to defer income taxes on capital gains reinvested in Oregon businesses. A state review of the program, however, found that it failed to produce additional investments or jobs.

The Silverton-based think tank’s report comes as a task force created by the state legislature and appointed by the governor undertakes a comprehensive review of Oregon’s tax system. OCPP executive director Chuck Sheketoff is a member of the Revenue Restructuring Task Force.

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OCPP's report dismissed claims that Oregon's system of treating capital gains income the same as income from work acts as a drag on the state's economy, pointing to the fact that this decade Oregon's economy has grown by nearly 45 percent, ahead of the 43 percent growth nationally. The OCPP report also notes that since the end of the 2001 recession, job growth in Oregon has been significantly stronger than in the rest of the country.

"Oregon's most serious economic problem is not sub par growth, but the growing gap between the haves and have-nots," said Leachman. "A cut in the income tax on capital gains would exacerbate that disparity."

If Oregon went the special treatment route and halved the tax rate for capital gains income, 70 percent of the tax savings would go to the wealthiest 1 percent of Oregonians, whose annual incomes average over \$1 million, according to OCPP. By contrast, 60 percent of Oregonians would effectively receive nothing.

Also, providing such special treatment would directly harm most Oregonians, because it would slash state revenue, the report added. This would force cuts in essential services or increases in other types of taxes. For example, OCPP estimated that halving the tax rate on income from capital gains would lower revenue by about \$546 million per biennium — more than what the state spends on all of Oregon's 17 community colleges.

Among the 42 states, counting the District of Columbia as a state, that levy a broad-based income tax, only 10 give significant preferential treatment to income from capital gains, according to OCPP. The governor of one of those states, Vermont Governor Jim Douglas, recently called for ending the "grossly unfair" special treatment. Douglas, a Republican, said the preferential treatment was an "unfair penalty for doing an honest day's work."

The Oregon Center for Public Policy is a non-partisan research institute that does in-depth research and analysis on budget, tax, and economic issues. The Center's goal is to improve decision making and generate more opportunities for all Oregonians.