NEG

We negate Resolved: The United States should Abolish the Capital Gains Tax.

Contention One: Opportunity Zones

Medium explains that

> Today, the map of economic growth is becoming increasingly uneven, and **more than 50 million Americans live in a distressed community that has seen continued loss of jobs and businesses–in spite of the nation's economic recovery.**

Fortunately, the capital gains tax ensures that investment goes to the people who need it most

Bank 2017 writes that

Among the many provisions of the Republican tax bill signed by President Trump in December [has an] is the new "Investing for Opportunities Act," [from the December tax bill] which lets investors temporarily defer taxes by investing their capital gains in distressed areas designated as "opportunity zones [areas where the poverty rate exceeds 20%]."

The Economist reports that
These opportunity zones use tax incentives to create new financial vehicles, not unlike venture-capital firms, with a place-specific investment mission. [This would] provide access for investors to regional-investment opportunities, turning struggling parts of rich countries into domestic versions of emerging markets, So rather than attempting to seed clusters, which caused previous "Enterprise Zones" to fail, The idea was to the Opportunity Fund focuses on spreading know-how in order to increase the attractiveness of laggard regions to productive firms.

The EIG in 2018 explains that investors pay less tax the longer they hold the investment. By 2028, an investor will be $44 better off for every $100 invested into Opportunity funds than a traditional stock portfolio.

The EIG continues that there is also a permanent exclusion on any gains accrued from investments in the Opportunity Fund.

A **permanent exclusion from taxable income of capital gains** from the sale or exchange of an investment in a qualified opportunity zone fund, if the investment is held for at least 10 years. (Note: this exclusion applies to the gains accrued from an investment in an Opportunity Fund, not the original gains).

That's why the New York Times in January writes that investors are already starting to take notice.

Abolishing the tax means that this comparative advantage of opportunity zones disappears.

The HBR explains

Economic activity in and around inner cities will take root if it enjoys a competitive advantage and occupies a niche that is hard to replicate elsewhere. If companies are to prosper, they must find a compelling competitive reason for locating in the inner city. The investment community must be convinced of the viability of investing in the inner city, which is particularly aided by capital gains exclusions.

Troyan 2016 writes that

Based on previous tax credit programs, [this exclusion] could lead to $17 billion annually in new investments in opportunity zones around the country to improve conditions in places with chronically high poverty and unemployment.

These programs have worked in the past.

According to the Community Development Financial Institutions CDFI Fund in 2016,

A 3 billion dollar Tax Credit that encouraged investment into low income communities financed 530 businesses, and 37,600 jobs.

Promoting growth in these low-income areas is crucial, as **Sharkie from New York University writes 2009** neighborhood poverty alone accounts for a greater portion of the black-white downward mobility gap than the effects of parental education, occupation, labor force participation, and a range of other family characteristics combined.

Contention Two: Short-Termism

Semuels 2016 explains that short-termism occurs when

> Now, a growing group of business leaders is worried that **companies are** too concerned with short-term profits, **focused only on making money for shareholders. [rather than innovation or employment]** As a result, they're not investing in their workers, in research, or in technology—short-term costs that would reduce profits temporarily. And this, the business leaders say, may be creating long-term problems for the nation.

Abolishing the tax fuels short-termism in two ways.

First, by eliminating holding periods

Zacks explains that currently, the tax on investments held for less than a year is higher than investments held for longer than a year, a difference known as a holding period. This incentivizes investors to hold investments for longer to avoid a high tax.

Eliminating this incentive creates a push to short-term investment.

Salter 2014 writes

> The **[An] undifferentiated holding period** that does not incentivize long-term holdings] required for capital gains treatment has two perverse effects. First, by failing to distinguish between truly long-term gains and, say, a 366-day gain, and by failing to treat these two cases differentially, the holding period provision **contributes to a short-term** business **culture where the investment time horizon** and risk preferences of fund managers and corporate executives **shift towards the here and now.** There is little positive incentive for fund managers and corporate executives to behave in ways consistent with two of the primary objectives of our capital gains tax regime—stimulating innovation and economic growth. Second, as I argue below, our increasingly short-term business culture invites various forms of lawful but corrupt behavior that weakens the social contract between business and the citizenry at large.

This short-termism is problematic because

Salter continues that

> However, **the commitment of** many public **companies to** empowering **innovation [is significantly undercut]** has weakened in recent decades—even broken down—**as** corporate **executives** have become increasingly reliant on efficiency-based performance measures and as fund managers and executives alike have **become preoccupied with near term earnings and stock prices.** Knowing that beating the next quarter's earnings expectations by as little as a penny can boost a company's stock price, or avoid a sharp price decline, executives have strong incentives to curb or minimize long-term investments in empowering technologies.

Second, by incentivizing buybacks

Investopedia explains

> **A buyback,** also known as a repurchase**, is the purchase by a company of its** outstanding **shares that reduces the number of its shares on the open market**

Companies always want to buyback shares because it increases the price of their stocks.

Ong from the Inquirer in 2017 explains

> **When a company repurchases its own shares, it reduces the supply of stocks,** total number of shares held by the public**,** effectively **raising** the percentage ownership of the remaining shareholders and hopefully **the share price.**
>
> At first glance, it will appear that stock buybacks create value for the company because dividing the same net income with fewer shares available in the market increases the Earnings per Share (EPS) of the stock. A higher EPS leads to a higher share price.

Currently, companies can't buy back in large quantities because investors aren't willing to sell.

Mitchell 2014 explains that investors don't want to pay the capital gains tax so they don't sell, a phenomenon known as the "lock-in effect".

Sikes from the University of Pennsylvania furthers that because shareholders are unwilling to sell their stocks, companies are unable to repurchase them.

However, abolishing the capital gains tax changes this.

Sikes writes empirically that

Similarly, I provide evidence that unrealized capital gains of tax-sensitive investors are more positively related to research and development expenses (R&D) prior to the 1997 capital gains tax rate cut than after. Prior studies show that tax-sensitive **investors unlocked their gains immediately following [the 1997] tax rate cut** (e.g., Blouin et al. 2017).

and

My finding of a significantly diminished negative relation between repurchases and unrealized gains of tax-sensitive investors in the second quarter of [When the capital gains tax rate was cut in] 1997 is consistent with the **[this]** "unlocking" of gains by tax-sensitive institutions in this quarter **increas[ed]**ing **the supply of shares** available **for repurchase.**

She concludes that,

The economic magnitude suggests that **had the lock-in effect been 15 percentage points lower,** aggregate **repurchases would have been $422 billion greater.**

Unfortunately, allowing companies to increase buyback is problematic as Sikes furthers that

My findings are consistent with **firms [cut funding for research and development]** cutting capital expenditures and R&D following the tax rate cut **in order to free up cash flow and take advantage of the increased supply of shares available to repurchase.**

Cutting R&D investment is detrimental for two reasons
First, is job creation
Hewson 2016 reports

> For instance, a recent study by Huo (2015) revealed that **each 1 percent increase in R&D expenditure** in the United States **raises the employment rate by 0.38 percent.**

CNN explains why, writing that

> empowering **innovations create jobs, because they require** more and more **people who can build, distribute, sell, and service these products.**

Second, long term economic growth
The US Chamber Foundation reports

> Economists have calculated that **approximately 50% of U.S. annual GDP growth is attributed to increases in innovation.**

This is because innovation gives American products a competitive edge in the global market.

Thus we are proud to negate.