We affirm resolved: The United States should abolish the capital gains tax.

Our sole contention is encouraging investment

The capital gains tax discourages investment for two reasons.

First, it locks-in investments.

The capital gains tax rewards long-term investment. **The Carlton Financial Group** explains in **2017** long term capital gains have a lower tax rate to incentivize investing over trading. Unfortunately, this incentivizes investors to latch onto falling stars. **Minz from the Financial Post** reports in **2012** the "lock-in" effect arises from the incentive to hold assets to avoid capital gains taxes. This hurts economic growth since investors are unwilling to sell off poorer-performing assets for better ones. **Mack from the Joint Economic Committee** quantifies in **1999** more than $7.5 trillion exist in unrealized capital gains. Lowering capital gains tax rates could "unlock" [much of this to] invest in new companies

Second, inflation.

Edwards of the CATO Institute explains that the CGT doesn't account for inflation and ends up taxing investments that didn't make any real profit. For example, if an individual buys a stock for $10 and sells it years later for $12, much of the $2 in capital gain may be inflation, not a real return. Inflation reduces real returns and increases uncertainty, which suppresses investment. **Bedard at the MEI** explains that since the CGT doesn't take inflation into account, projects that have made no real capital gains, or worse, that have incurred losses in real terms despite a higher nominal value, can be made to lose money through this tax alone. **Kerpen of the Institute for Policy Innovation** quantifies that in three of the four stock indexes investors paid capital gains taxes on investments that on net lost money after adjusting for inflation.

For all these reasons, **Mitchell of Forbes** finds empirically, decreasing capital gains taxes by 4.0 percentage points leads to [up to] 2.0 percent increase in investment.

The impact to increasing investment is **two-fold**.

First, building small businesses

Edwards of the CATO Institute explains that reduced capital gains taxes boost investment from venture capitalists because their reward for taking risks on unproven young companies is a possible gain years down the road. The higher the tax rate on gains, the more investors want in return, and the fewer potential projects will get the green light. **Kerpen from the Institute for Policy Innovation** finds empirically in **2001:** the capital gains tax cut of 1997 corresponded with a nearly 50 increase in risk capital funding percent between 1997 and 2000. **Hakobyan of the Huffington Post** explains in **2016** that policies that encourage the growth of small businesses and the role of entrepreneurship in the market are considered to be healthy for the economy at large. In 2012, small businesses had created 64% of the new jobs in the previous decade. Overall, **Sinai of the American Council for Capital Formation** finds empirically that abolishing the capital gains tax will lower the unemployment rate by 0.7% and create 1.3 million jobs per year.

Second, research and development

West of the Brookings Institute reports in **2017** that since 2010 R&D spending has plateaued. **Brown of Iowa State** furthers in 2016 R&D is of interest because it is a critical driver of innovation and technological change in modern economies. Overall, he finds reducing the effective tax rate on corporate payouts to 0% increases R&D investment by approximately 5%. **Prieto of Georgetown University** quantifies this is crucial as a one percentage point increase in R&D expenditures as percentage of GDP increases GDP growth by 2.28 percentage point

For these reasons, we affirm.

We affirm resolved: The United States should abolish the capital gains tax.

Our sole contention is **increasing investment**

Abolishing the capital gains tax will increase the amount of investment flowing into the economy in **five** ways.

First, competition

Conda of the National Review explains that the U.S. is in the middle of the pack within the OECD countries burdening U.S. global competitiveness.

Cesar Conda (National Review). “The Best Cap-Gains Tax Rate Is Zero.” March 10, 2006.
http://www.nationalreview.com/article/217016/best-cap-gains-tax-rate-zero-cesar-conda

The best way for the federal government to foster innovation, economic growth, and U.S. global competitiveness is to stop taxing capital gains. While the current debate in Washington centers on whether the capital-gains rate should stay at 15 percent or increase to 20 percent in 2008, I contend that the best rate is zero. **According to the American Council for Capital Formation, our current 15 percent individual capital-gains tax rate puts us in the middle of the pack within the OECD** (the Organization for Economic Cooperation and Development). **In fact, fourteen of thirty OECD countries do not tax individual capital gains at all.** China — an emerging economic powerhouse — exempts domestic investors from the capital-gains tax and recently extended that exemption to foreigners. Similarly, the U.S. corporate capital-gains tax of 35 percent is far higher than the 23 percent average of our OECD competitors. **Our punitive capital-gains tax burdens our global competitiveness.** First, it produces a “lock-in” effect, discouraging both individual and corporate taxpayers from selling capital assets and realizing capital gains because of the high tax costs. This prevents hundreds of billions of dollars in capital from flowing to its most efficient and productive uses. As President John F. Kennedy put it in 1963, “The tax on capital gains directly affects investment decisions, the mobility and flow of risk capital … the ease or difficulty experienced by new ventures in obtaining capital, and thereby the strength and potential growth in the economy.” Second, the capital-gains tax is a “double tax” that encourages firms to finance expansion by taking on more debt rather than selling capital and financial assets. Here’s what happens: With the capital-gains tax in place, income is first taxed at the corporate level and then again at the individual level when shareholders sell their corporate stock. By contrast, because interest expenses are tax deductible, debt-financing is taxed only once. So businesses borrow against their existing assets instead of selling assets, which undermines the financial stability and flexibility of many companies.

The capital gains tax has hurt US investment. Jim Saxton of the Joint Economic Committee reports in 2015

Jim Saxton "The Economic Effects of Capital Gains Taxation" *Joint Economic Committee* 2 Jun. 2015. Web. 15 Feb. 2018.
<https://www.jec.senate.gov/public/_cache/files/b3116098-c577-4e64-8b3f-b95263d38c0e/the-economic-effects-of-capital-gains-taxation-june-1997.pdf>

Unfortunately, **the level of investment in the United States compares unfavorably with that of other countries** and with the United States' own history. **Annual U.S. investment is only half the level it was in the 1960s and 1970s**. In addition, net private domestic investment dropped from an average of 7.4 percent of gross domestic product (GDP) between 1960 and 1980 to an average of only 3.0 percent since 1991.1 Consequently, **the growth rate of the capital stock in the United States has also been declining.** Figure 1 shows a clear downward trend in the growth rate of the non-residential stock of capital. This downward trend has serious implications for the economy given the strong relationship between investment and economic growth

Second, double taxation

Barro of Harvard University explains that with the capital gains tax,

Robert J. Barro (New York Times/professor of economics at Harvard University/senior fellow at the Hoover Institution). “How to Really Save the Economy.” September 10, 2011. http://www.nytimes.com/2011/09/11/opinion/sunday/how-to-really-save-the-economy.html
I received vigorous criticism from conservatives after advocating a VAT in an essay in The Wall Street Journal last month. The main objection — reminiscent of the complaints about income-tax withholding, which was introduced in the United States in 1943 — is that a VAT would be a money machine, allowing the government to readily grow larger. For example, the availability of easy VAT revenue in Western Europe, where rates reach as high as 25 percent, has supported the vast increase in the welfare state there since World War II. I share these concerns and, therefore, favor a VAT only if it is part of a package that includes other sensible reforms. But given the likely path of government spending on health care and Social Security, I see no reasonable alternative. Abolishing the corporate income tax is similarly controversial. Any tax on capital income distorts decisions on saving and investment. Moreover, the inefficiency is magnified here because of double taxation: **the income is taxed [once] when corporations make profits and again when owners receive dividends or capital gains.** If we want to tax capital income, a preferred method treats corporate profits as accruing to owners when profits arise and then taxes this income only once — whether it is paid out as dividends or retained by companies. Liberals love the idea of a levy on evil corporations, but taxes on corporate profits in fact make up only a small part of federal revenue, compared to the two main sources: the individual income tax and payroll taxes for Social Security and Medicare.

Since this increases the cost of investment, Carroll of LLP finds in 2012 that:
Drs. Robert Carroll and Gerald Prante (Ernst & Young LLP). “Corporate Dividend and Capital Gains Taxation: A comparison of the United States to other developed nations.” February 2012.
https://www.realclearmarkets.com/blog/EY_ASI_Dividend_and_Capital_Gains_International_Comparison_Report_2012-02-03[1].pdf
Taking into account both the corporate and investor level taxes on corporate profits and state level taxes, the United States has among the highest integrated tax rates among developed countries and these integrated tax rates will rise sharply in 2013: The current top US integrated dividend tax rate of 50.8 percent will rise to 68.6 percent in 2013, significantly higher than in all other OECD and BRIC countries. The current top US integrated capital gains tax rate of 50.8 percent will rise to 56.7 percent in 2013, the second highest among OECD and BRIC countries. Most developed countries provide relief from **the double tax on corporate profits** because it **distorts important economic decisions that waste economic resources and adversely affect economic performance: It discourages capital investment, particularly in the corporate sector, reducing capital formation and, ultimately, living standards.** It favors debt over equity financing, which may result in greater reliance on debt financing and leave certain sectors and companies more at risk during periods of economic weakness. A tax policy that discourages the payment of dividends can impact corporate governance as investors’ decisions about how to allocate capital are disrupted by the absence of signals dividend payments would normally provide.

Third, locking-in assets.

The capital gains tax rewards long-term investment. The Carlton Financial Group explains in 2017
" Capital Gains vs. Dividends: What’s the difference?." *Carlton Financial Group*. 9 Nov 2017 Web. 15 Feb. 2018. <https://carltonfinancialgroup.com/blog/capital-gains-vs-dividends-whats-the-difference>
The most important phrase in the previous sentence: you decide. You decide when you want to recognize the return on an asset. If you don’t want to pay taxes on it this year, and you’d rather wait until next year to recognize the gains, then you don’t have to sell the asset. You won’t have to pay any taxes on the gains until you decide to sell. **Short-term versus long-term capital gains are** also **taxed differently, with a lower tax rate on long-term capital gains to incentivize investing over trading.** The tax treatment of capital gains can help lower your taxable income in a given year. If you have lost money on an investment and are considering changing your investment strategy, you can sell the asset for a loss and receive a tax benefit from the losses incurred on the asset (This is never the primary reason to sell). Note that it is illegal to sell an asset, recognize the loss, and then buy the exact same asset again within 30 days. However, if you have already been thinking about selling an investment for other reasons, the losses can be wisely used to lower your taxable income.

Unfortunately, this incentivizes investors to latch onto falling stars. Minz from the Financial post reports in 2012
Jack Mintz (Financial Post/University of Calgary). “Jack Mintz: The lock-in effect.” January 12, 2012.
http://business.financialpost.com/opinion/jack-mintz-the-lock-in-effect

With the upcoming budget, the Conservatives have an opportunity to implement a 2006 campaign promise to let Canadians rebalance portfolios without triggering capital gains taxes, so long as they replace one asset for another. This measure would reduce significantly **the "lock-in" effect** that **arises from the incentive to hold assets to avoid capital gains taxes on disposals. Inertia in portfolio adjustments hurts economic growth by undermining stock-price signals, since investors are unwilling to sell off poorer-performing assets for better ones.** Tom Wilson at the University of Toronto and I recommended in 2006 a measure that could implement the Conservative proposal. We proposed a "capital gains deferral account" that would enable investors to roll over assets in the account on a tax-free basis. Only when withdrawals are made from the account would capital gains be subject to tax. We thought this would be an eminently sensible approach to reduce the impact of the "lock-in" effect due to capital gains taxation. If a lifetime limit were provided equal to $150,000 invested in the deferral account, we estimated the revenue costs would be $425-million in federal and provincial personal taxes. Probably, this is an overestimate of the revenue impact since we assumed stock market values would rise annually by 6.3% based on the 1976-2006 experience, which is more than what would be reasonable to consider today. A larger limit is probably more affordable. With tough fiscal times, a tax measure like this would be criticized as a sop to the rich. Yet, as most investors know (Warren Buffett excepted), capital gains reflect estimated changes in future corporate profits, net of corporate tax payments. Corporate taxes therefore reduce distributions and capital gains. The existing capital gains tax rate (applied to one-half of ordinary personal income) and the dividend tax rate (net of the dividend tax credit), is a second tax on income generated by business profits.

Mack from the Joint Economic Committee quantifies in August 1999

Connie Mack "Cutting Capital Gains Tax Rates: The Right Policy for the 21st Century" *Jec.senate.gov*. Aug 1999. Web. 8 Feb. 2018. <https://www.jec.senate.gov/public/_cache/files/1c3a5162-63fa-411e-8e4b-f85e910869a0/cutting-capital-gains-tax-rates-whitman-august-1999.pdf>

Because of this incarceration of capital in old investments, the capital gains tax is inefficient and retards economic growth. It leads investors to make decisions for tax reasons instead of for underlying economic factors. By liberating currently locked-in gains, unleashing a torrent of realizations, and diminishing the extent of this detrimental phenomenon in the future, lowering capital gains tax rates and indexing gains for inflation would increase efficiency and improve long-term economic growth. The enormous value of unrealized capital gains reveals the extent of the lock-in effect. By one calculation, on average "only 3.1 percent of the stock of accrued gains was realized in any given year during the 1960-1984 period."32 Moreover, some studies suggest that **more than $7.5 trillion exist in unrealized capital gains.** Therefore, **lowering capital gains tax rates** and indexing gains for inflation **could "unlock" hundreds of billions of dollars of tied up assets**.33 For example in 1996, by one assessment, there was approximately $3.5 trillion in unrealized capital gains just in common stocks, excluding mutual funds and pensions.34 With the dramatic rise in stock prices since 1996, even with the tremendous surge in capital gains realizations since the 1997 tax cut, that locked in amount has increased to at least $4 trillion and probably more than $5 trillion. By freeing locked-in assets such as these, lowering capital gains tax rates and indexing gains for inflation would increase economic efficiency while substantially expanding the tax base. Investors would **[to] invest** this emancipated capital **in new companies**, creating more jobs, developing innovative goods and services, and spurring greater economic expansion.

Fourth, more expensive start-ups

Edwards of the CATO Institute explains that due to the CGT start-ups never get the green light.

Chris Edwards (The CATO Institute). "Six Reasons to Keep Capital Gains Tax Rates Low." December 27, 2012. https://www.cato.org/publications/commentary/six-reasons-keep-capital-gains-tax-rates-low

The higher the tax rates on capital, the more job-creating investments are scared away. When Canada cut its federal capital gains tax rate to 14.5%, a parliamentary report proposed that "international competitiveness be the criterion guiding the choice of a capital gains tax regime." 5. Growth Companies. **Reduced capital gains taxes encourage entrepreneurship because the capital-gain payoff from a successful start-up is improved relative to a wage job. Low taxes also boost outside investment from angels and venture capitalists because their reward for taking risks on unproven young companies is a possible gain years down the road. The higher the tax rate on gains, the fewer potential projects will get the green light.** Angel investors are usually high-earners who could alternatively invest in safer assets, such as in tax-free municipal bonds. **The capital gains tax rate directly affects** their **[investor's] willingness to fund start-ups and growth companies.** Furthermore, when angels exit their investments, they often use their after-tax returns to fund more young companies in an ongoing virtuous cycle. Higher capital gains taxes would drain cash out of that reinvestment cycle, which has been at the core of Silicon Valley's success since capital gains taxes were slashed in the late 1970s. 6. Government Revenue. A recent

Congressional Budget Office study found that the longer-term responsiveness of capital gains realizations to the tax rate is quite large. It found a persistent elasticity of -0.79, which means that a 10% cut in the tax rate would increase ongoing realizations by 7.9%.

Even when entrepreneurs are willing to start a business, Gentry of Williams College explains that by creating a transaction cost for selling the firm, the capital gains tax cause entrepreneurs hold their businesses inefficiently long, rather than starting new businesses. He confirms this empirically finding that eliminating the capital gains tax would increase the percentage of entrepreneurs who sell a business in a period from 10 percent to 29 percent.

William M. Gentry (Professor of Economics Williams College). "Capital Gains Taxation and Entrepreneurship." March 2016. https://www.law.upenn.edu/live/files/5474-capital-gains-taxation-and-entrepreneurship-march

Cavalcanti and Ersoa consider two possible policy experiments: (1) a fifty percent reduction in the capital gains tax rate (from 28 to 14 percent); and (2) indexing basis for inflation (the major source of capital gains in their framework). Both of these policy changes substantially increases the rate of business turnover – to 11 percent per year with the lower tax rate and 7 percent per year with indexing of basis. Given the substantial increase in turnover, it is not surprising that Cavalcanti and Erosa estimate that these policy changes for the taxation of closely-held businesses would be self financing.26 In terms of welfare effects, they estimate that eliminating the capital gains tax on entrepreneurs and replacing the revenues with a lump sum tax would increase total output by 0.48%; for comparison, the revenue from taxing these capital gains in their model is only 0.03%. These calculations suggest a substantial welfare loss from taxing the capital gains of entrepreneurs. Chari, Golosov, and Tsyvinski (CGT) emphasize that some individuals have a comparative advantage in creating new businesses; however, **creating a new business requires focused attention so these entrepreneurs are best suited to attend to one business at a time. CGT refer to these individuals as "serial entrepreneurs." Once the business has been established, economic efficiency is enhanced by the entrepreneur selling the firm to professional managers and potentially starting another new business. By creating a transaction cost for selling the firm, the capital gains tax creates a lock-in effect by which entrepreneurs hold their businesses inefficiently long.** CGT build a general equilibrium model to quantify the magnitude of this inefficiency; they choose parameters for the model that match the percentage of households who are entrepreneurs and the fraction of total income earned by entrepreneurs. In their model, **eliminating a capital gains tax rate of 20 percent would increase the percentage of entrepreneurs who sell a business in a period from 10 percent to 29 percent – roughly a tripling of the rate at which entrepreneurs sell successful businesses instead of manage the business themselves.** Given that business sales are quite sensitive to the capital gains tax rate, it is not surprising that CGT conclude that the revenue maximizing capital gains tax rate on entrepreneurs is roughly 15 percent.27

Phil Kerpen (The Institute for Policy Innovation). "A Capital Gains Tax Cut: The Key to Economic Recovery." October 11, 2001. http://www.ipi.org/ipi_issues/detail/a-capital-gains-tax-cut-the-key-to-economic-recovery

The supply side critics were famously wrong in their predictions about the fiscal impact of a capital gains tax cut. Michael Kinsley of Slate and others wrote that a capita gains cut would reduce federal revenues by $75 billion over five years. Instead, the rate cut is on pace to have raised capital gains revenues by $100 billion. What accounts for this giant forecasting error? The reliance on static revenue forecasting and the failure to take account of the economic adrenaline that a capital gains tax cut can provide. The lesson here is that the impact of tax changes cannot be properly predicted without assessing how the tax policy changes will influence the behavior of workers, entrepreneurs and investors. All over the world tax rates are falling as political leaders realize that high tax rates do not redistribute income, they redistribute people. The static economic model used by the Joint Tax Committee and the Congressional Budget Office should be discarded because it has proven again and again that it has no predictive powers. **The capital gains tax cut of 1997 corresponded with two other positive economic trends. First, risk capital funding for new business start-ups increased by nearly 50 percent between 1997 and 2000.** If we want an investment-led recovery, then capital gains cuts are crucial. Here is the data for the venture capital funding explosion after the capital gains cut:10

Fifth, taxing losses

Edwards of the CATO Institute explains that the CGT doesn't account for inflation and ends up taxing people and corporations on investments that they didn't make any real profit on.

Chris Edwards (The CATO Institute). "Six Reasons to Keep Capital Gains Tax Rates Low." December 27, 2012. https://www.cato.org/publications/commentary/six-reasons-keep-capital-gains-tax-rates-low

The average tax rate on capital gains among the 34 nations of the Organization for Economic Cooperation and Development is just 16.4%, By contrast, the U.S. rate including both federal and state taxes will jump to 27.9% next year. U.S. policymakers need a refresher on why capital gains tax rates should be kept low. 1. Inflation. **If an individual buys a stock for $10 and sells it years later for $12,**

much of the $2 in capital gain may be inflation, not a real return. Inflation — and expected inflation — reduce real returns and increase uncertainty, which suppresses investment, particularly in growth companies. One solution is to index capital gains for inflation, but most countries instead roughly compensate for inflation by reducing the statutory rate on gains or providing an exclusion to reduce the effective rate. 2. "Lock-In." Capital gains are taxed on a realization basis, which creates lock-in. Taxpayers delay selling investments that have large unrealized gains to avoid the tax hit. As a result, people hold assets too long and forgo beneficial diversification opportunities. For the overall economy, lock-in reduces growth because it blocks the beneficial shifting of resources from lower- to higher-valued uses.

Bedard at the MEI explains that since the CGT doesn't take inflation into account long-term projects that have made no real capital gains, or worse, that have incurred losses in real terms despite a higher illusory nominal value, can be made to lose money (or lose even more money) through this tax alone.

Mathieu Bédard (Economist at the MEI/Montreal Institute of the Economy). "THE CAPITAL GAINS TAX: IT SHOULD BE REDUCED, NOT INCREASED." November 2017. https://www.iedm.org/sites/default/files/web/pub_files/note0717_en.pdf

The capital gains tax does not just reduce overall investments; it also affects which business ventures capitalists invest in. Venture capital tends to go to firms that offer unproven but potentially revolutionary technologies, services, or products. As they are unproven, they tend to be riskier but also, if successful, quite profitable. When they succeed, firms that have access to venture capital act as potent stimulants to economic growth, as well as productivity growth.4 The capital gains tax, however, reduces the willingness of venture capitalists to finance these riskier business start-ups. As a result of the deterrent effect of the tax, they prefer less innovative forms of entrepreneurship.5 **Finally, while inflation itself is often likened to a tax because of how it chips away at the value of money, the capital gains tax does not take it into account, thereby increasing the effect of the tax, especially for long-term projects.6 An investment whose nominal value has increased 5%, but whose real value has only increased 3%, the rest being due to inflation, will still be taxed on the full, partly illusory 5%. This is because the tax applies to the nominal return on capital, without adjusting for the fact that inflation may have substantially reduced the real value of this return. What this means is that long-term projects that have made no real capital gains, or worse, that have incurred losses in real terms despite a higher illusory nominal value, can be made to lose money (or lose even more money) through this tax alone.**7 **These effects of the capital gains tax represent one of the biggest fiscal burdens on economic performance** in Canada. In a study of the macroeconomic effects of the different taxes that governments can use to raise revenues, the federal Department of Finance found that taxes that affect capital goods are the most detrimental to economic activity. As Figure 1 shows, **each dollar of reduction of taxes on capital income would lead to economic gains of approximately $1.30. It is the tax whose elimination would bring the most gains.**

Kerpen of the Institute for Policy Innovation quantifies that in three of the four stock indexes investors paid capital gains taxes on investments that on net lost money after adjusting for inflation. For example, over a 20 year period the average real tax on the Dow Jones was an astounding 233 percent.

Phil Kerpen (The Institute for Policy Innovation). "A Capital Gains Tax Cut: The Key to Economic Recovery." October 11, 2001. http://www.ipi.org/ipi_issues/detail/a-capital-gains-tax-cut-the-key-to-economic-recovery

One of the least fair features of the capital gains tax is that it taxes gains that may be attributable only to price changes, not real gains. That is because the capital gains tax, unlike most other elements of the U.S. tax code, is not indexed for inflation. The nonpartisan Tax Foundation reports that that can have major distortion effects on what an individual pays in capital gains taxes and can—indeed, **often** does—lead to circumstances in which **investors "pay effective tax rates that substantially exceed 100 percent of their gain."**46 As an example, consider the following hypothetical case. If an investor purchased a $10,000 diversified portfolio of stock in 1970 as a retirement nest egg, and that stock appreciated in value at the same rate as the Dow Jones Industrial Average over the next 20 years, then it could have been sold when the investor retired in 1989 for roughly $28,000. Yet that stock would have had to be sold for about $31,000 to have kept pace with the rate of inflation over that 20-year period. Hence, the investor suffered a real loss in purchasing power of about $3,000 on the stock. Nonetheless, under current law the retiree would have to pay $5,040 in capital "gains" tax (assuming he is in the 28 percent tax bracket) on an investment that produced a real $3,000 capital loss. That means that the investor would pay a 129 percent tax rate on the investment.47 It is not at all uncommon for taxpayers to pay capital gains tax rates that high. T**hen-Federal Reserve Board governor Wayne Angell calculated in 1993 that the average real tax rate on investments in NASDAQ stocks from 1972 to 1992 had been 68 percent.**48 **The real tax rate on investments in the Standard & Poor's Composite Index over the same time period was 101 percent. The average real tax on a portfolio of New York Stock Exchange stocks was 123 percent. And the average real tax on the Dow Jones Industrial Average over that 20-year period was an astounding 233 percent. In other words, according to three of the four indexes, investors paid capital gains taxes on investments that actually lost money after adjusting for inflation—and thus the tax simply diminished the principal.** Angell concluded, "If we are to reduce the damaging effects that we know are caused by all capital taxation, it makes sense to eliminate the worst aspect of the most damaging tax on capital—the tax on phantom gains. The tax on real capital gains is a middle-of-the-road bad tax. But the tax on nominal capital gains without regard to whether the gain is real or only the effect of inflation is truly the worst tax." 49 **Even investments that are held for a relatively short period of**

time, one year, are taxed at a significantly higher effective rate than the statutory 20 percent. Historically, inflation has caused effective rates to be much higher than statutory rates, which is one explanation for the slowdown of the early 1990s, as the chart shows.50 To illustrate this effect another way, look at the nominal and real rise of the stock market over time. As the chart shows, there is a very large gap that represents gains due exclusively to inflation. There is no valid rationale for taxing these "gains."

For all these reasons, Mitchell of Forbes finds empirically,

Daniel J. Mitchell, 14, 11-7-2014, The Overwhelming Case Against Capital Gains Taxation, Forbes, https://www.forbes.com/sites/danielmitchell/2014/11/07/the-overwhelming-case-against-capital-gains-taxation/#5cc1dd553b0a , 1-29-2018, (NK)

Then the authors analyze the impact of capital gains taxes on the "user cost" of capital investment. Capital gains taxes make capital investments more expensive and therefore less investment occurs. ...Several studies have investigated the link between the supply and cost of venture capital financing and capital gains taxation, and found theoretical and empirical evidence suggesting a direct causality between a lower tax rate and a greater supply of venture capital. ...Kevin Milligan, Jack Mintz, and Thomas Wilson (1999) sought to estimate the sensitivity of investment to changes in the user cost of capital...and found [specifically] that **decreasing capital gains taxes by 4.0 percentage points leads to a 1.0 to 2.0 percent increase in investment.** Next, they investigate the impact on entrepreneurship. Capital gains taxes reduce the return that entrepreneurs and investors receive from the sale of a business.

Moore of the CATO Institute continues that:

Stephen Moore. "CATO INSTITUTE POLICY ANALYSIS no. 242: The ABCs of the Capital Gains Tax." CATO Institute. October 4 1995. https://object.cato.org/sites/cato.org/files/pubs/pdf/pa242.pdf

The House GOP proposal to reduce the capital gains tax rate to 19.8 percent and index gains for inflation would be a vast improvement over the current tax system. But because the capital gains tax is a form of double taxation, and an economically destructive tax on capital formation, the most equitable and appropriate capital gains tax is zero.[93] Several proposals now before Congress promote the concept of a zero capital gains tax. House Majority Leader Dick Armey's flat-tax legislation would eliminate the capital gains tax.[94] A 1994 analysis by former Treasury economists Gary and Aldona Robbins compared the economic effect of six prominent capital gains tax proposals--including the GOP plan and the zero rate. **The analysis showed that eliminating the capital gains tax would have by far the most positive impact on long-term economic growth in the United States.**[95] As Table 14 indicates, **after five years the zero capital gains option leads to a $300 billion increase in national output ($3,000 per household), 877,000 additional jobs, and $2.5 trillion of additional capital. Additional tax revenues of $46 billion would be raised for the federal government as a result of added growth.** The Robbinses find that that is almost twice the positive impact of the 50 percent exclusion and indexing plan proposed by the GOP. In the long run it appears that **a capital gains tax cut is the fairest and the most economically stimulative tax change Congress could make.**

The impact of increasing investment is three-fold.

First, spurring entrepreneurship

Margarita Hakobyan . "The Role of Entrepreneurship in Job Creation and Economic Growth." *HuffPost*. 15 Nov. 2016. Web. 16 Feb. 2018. <https://www.huffingtonpost.com/margarita-hakobyan/the-role-of-entrepreneurs_b_12964394.html>

In the United States, small businesses are often called the backbone of the economy. **Policies that encourage the growth of small businesses and the role of entrepreneurship in the market are considered to be healthy for the economy at large.** What is the link between entrepreneurship and job creation? For a capitalist economy to thrive, there must be competition, growth, and innovation. Successful entrepreneurs tend to be naturally competitive, think outside of the box, and see through many of the easy answers to see how an industry could benefit from a fresh take. When the SBA said **in 2012**, for example, that **small businesses had created 64% of the new jobs in the previous decade**, this is how they got it done.

Second, research and development

James R. Brown, 27 July 2016, Iowa State University "Taxing Capital, Stunting Growth? Capital Income Taxes, Costly Equity Finance, and Investment in R&D*" //JN https://pdfs.semanticscholar.org/b28c/be53fb7a5aedc4f8135e7da1818e517185f5.pdf

This study documents an economically important negative relation between tax rates on capital income (dividends and capital gains) and R&D investment. Our analysis is based on two main ideas: i) **taxing corporate payouts raises the cost of capital for firms that are dependent on external equity** at the margin, and ii) **R&D should be particularly sensitive to the equity-financing distortion that results from payout taxation because firms cannot perfectly substitute debt for (costly) external equity when financing risky, intangible activities.** Using a broad panel of countries and industries, **we find strong evidence that higher rates of payout taxation have a negative impact on R&D, particularly in industries where the typical firm is more dependent on external equity to finance investment.** We also find support for these inferences by studying firm-level changes in R&D activity around the introduction of the 2003 dividend tax cut in the US. We are not aware of any prior studies that evaluate the real consequences of payout taxation by focusing specifically on R&D. This shift in focus is important because the real effects of payout taxation should be concentrated in the activities that are most equity dependent. Indeed, one implication of our study is that by focusing almost exclusively on investment in physical assets, prior research may readily understate (or miss entirely) the most important (long-run) economic effects of payout taxation. **R&D is of interest not only because it is a risky investment that is equity-dependent in nature, but also because it is widely viewed as a critical driver of innovation, creative destruction, and technological change in modern economies** (e.g., Aghion and Howitt (1992)). Thus, the negative association between payout tax rates and R&D investment that we document suggests payout taxes have much broader macroeconomic implications than prior research indicates.

James R. Brown (Iowa State University, College of Business, Department of Finance) and Gustav Martinsson (Royal Institute of Technology and Swedish House of Finance), 2015 Innovation, Finance and Law Conference: Fostering Innovation at the Toulouse School of Economics, July 27, 2016, ["Taxing Capital, Stunting Growth? Capital Income Taxes, Costly Equity Finance, and Investment in R&D," https://pdfs.semanticscholar.org/b28c/be53fb7a5aedc4f8135e7da1818e517185f5.pdf, DOA: 1-30-2018] // ATA

Do taxes on capital income affect the real economy? Economists and policymakers have debated the consequences of corporate payout taxation for decades.1 Although several studies find that tax rates on dividends and capital gains influence corporate payout policies and capital structure decisions (Chetty and Saez (2005); Lin and Flannery (2013)), there is little indication that the real effects of payout taxes are sufficient to impact aggregate economic performance. For example, recent evidence suggests that even substantial cuts in dividend tax rates have almost no impact on corporate investment in fixed capital (Yagan (2015)). This study departs from prior work on the real effects of payout taxation by focusing on intangible investments in research and development (R&D) rather than the accumulation of physical capital. This shift in focus matters: in both a broad international panel and in the years surrounding the sizeable 2003 US dividend tax cut, we find that lower taxes on dividends and capital gains have a significant positive impact on R&D investments but, consistent with other recent work, little or no effect on investment in fixed capital. **Reducing the effective tax rate on corporate payouts from 20% to 0% increases the overall average (long-run) rate of industry-level R&D investment by approximately 5%**, with substantially stronger effects in sectors and firms that depend more on external equity finance, indicating the economic consequences of capital income taxation are considerably larger than previously thought. There are two complementary reasons that focusing specifically on R&D yields important new insights on the economic effects of payout taxes. First, R&D is central to modern theories of endogenous economic growth, and there is widespread recognition that innovation rather than capital accumulation drives technological change and economic performance over the long run (e.g., Romer (1990); Aghion and Howitt (1992); R. G. King and Levine (1993); Grossman and Helpman (1994)). Thus, it is arguably essential to look beyond investment in physical capital to fully evaluate the long-run economic implications of corporate payout taxation.

Leonel José Prieto (Graduate School of Arts and Sciences of Georgetown University in partial fulfillment of the requirements for the degree of Master of Public Policy in Public Policy), Georgetown University, April 2017, ["INNOVATION AND ECONOMIC GROWTH: CROSS-COUNTRY ANALYSIS USING SCIENCE & TECHNOLOGY INDICATORS," https://repository.library.georgetown.edu/bitstream/handle/10822/1043935/Prieto_georgetown_0076M_13577.pdf?sequence=1, DOA: 1-30-2018] // ATA

To estimate the effect of innovation on economic growth in my sample of countries, I used fixed-effects and lagged R&D expenses as percentage of GDP have been for six years. Table 3 indicates that the coefficient of R&D expenses as percentage of GDP is positive and statistically significant. **According to these results a one percentage point increase in R&D expenditures as percentage of GDP increases GDP growth by 2.28 percentage points**, lagged to six years and controlling for gross enrollment ratio in secondary, foreign direct investment, and labor force. This might suggest that successful investments in R&D take 6 years to provide returns in the form of GDP growth, controlling for the aforementioned variables. Trademarks' applications filed have a negative and statistically significant effect. A one percent increase in trademarks' applications decrease GDP growth by 5/1,000,000 percentage points, controlling for gross enrollment ratio in secondary, foreign direct investment, and labor force. Even though this inverse relationship is unexpected, it can be stated that its impact is relatively small.

Third, stimulating the economy

Sinai of the American Council for Capital Formation finds empirically that abolishing the capital gains tax will lower the unemployment rate by 0.7% and creates 1.3 million jobs per year.

Allen Sinai (American Council for Capital Formation: Center for Policy Research by Decision Economics). "Capital Gains Taxes and the Economy." September 2010. *PDF in Google Drive*

The responses of inflation-adjusted consumption and business capital spending are presented for each year, 2011-16, and for the averages of those years. The effects on Research & Development expenditures also are shown. Changes in the financial position of nonfinancial corporations are indicated for some key parameters such as cash flow, "debt burden," "leverage," and the ratio of investment outlays to cash flow as a need for external financing. In almost no other macroeconometric model is there structure to assess nonfinancial corporate responses, real and financial, to changes in taxation. Generally, in simulations of hikes in the capital gains tax rate compared with current law the economy does worse, losing more in growth the higher is the capital gains tax rate and gaining when the rate is reduced to lower levels. Large changes occur in the stock market, mostly on reductions of earnings from a weaker economy and no offsetting reductions in interest rates. In the simulations, Federal Reserve policy was assumed to be unchanged. In actuality, the Federal Reserve might alter policy in response to changes in the economy and inflation. On an increase in the capital gains tax rate to 50%, the unemployment rate rises sharply, at its peak 0.7 percentage points above the Baseline. Nonfarm payroll jobs peak at negative 2 million three years after the tax increase and average approximately 1.6 million less jobs per annum. Quite the opposite can be seen **when the capital gains tax rate is reduced to 0%. A significant decline in the unemployment rate occurs, at most falling 0.7 percentage points below the Baseline. Strong increases occur in jobs, 1.854 million at the peak, and 1.323 million per annum.** With higher capital gains tax rates, business profits fall and the cash flow of nonfinancial corporations diminishes. The ratio of capital expenditures to cash flow rises, indicating increased demand for external financing by nonfinancial corporations. But, as the higher capital gains tax rates negatively impact on the economy, nonfinancial corporations work to improve financial positions by cutting borrowing and reducing leverage (the debt/equity ratio). The federal government budget deficit actually worsens when capital gains tax rates are raised.