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Budget Model

Analyzing President Trump's Proposed Capital Gains and Dividend Tax Cut

Summary: PWBM estimates that reducing the top preferential rates on capital gains and dividends from 20 percent to 15 percent will cost $98.6 billion dollars over the ten year budget window. This tax cut will only benefit tax units in the top 5 percent of the income distribution, with 75 percent of the benefit accruing to those in the top 0.1 percent of the income distribution.

Introduction

Over the past year, President Trump has mentioned nonspecific intentions to reduce the tax rate on capital gains. In August, White House National Economic Council director Larry Kudlow confirmed these intentions, citing the aim of a top 15 percent rate.

Current Law Treatment of Capital Gains and Dividend Income

A capital gain is realized when a capital asset is sold at a price higher than its purchase price. The profit made on the sale of this asset is called the capital gain and is included in an individual's taxable income. Income from both capital gains and dividends qualifies for "preferential treatment" if the asset is held for longer than one year. Capital gains income from assets held for less than a year is included in ordinary income and is taxed at ordinary rates. For our purposes here, "capital gains income" refers to income from long-term capital gains (those assets held for over a year).

The tax brackets that set the tax rates for capital gains and dividends are determined by level of taxable income. Under current law in 2020, no tax is owed on capital gains or dividend income if taxable income is below $40,000 for single filers ($80,000 for joint filers). Single (married) filers with taxable income between $40,000 ($80,000) and $441,450 ($496,600) face a 15 percent rate while income above that amount faces a 20 percent rate.

Budgetary Effects

This plan eliminates the top bracket under current law, and any single (married) filers with taxable income over $441,450 ($496,600) would face the 15 percent rate on capital gains and dividend income. PWBM modeled this scenario as a permanent rate cut set to begin in 2021.

Table 1 shows fiscal year budgetary changes as a result of the rate cut. We estimate the plan would reduce federal revenues by $98.6 B over the budget window 2021 - 2030.

Table 1. Conventional Revenue Estimate, Fiscal Years 2021 - 2030

Billions of Dollars, Change from Current-Law Baseline

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2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	Window Total
-7.5	-9.5	-9.7	-10	-10.4	-9.3	-9.7	-10.3	-10.8	-11.4	-98.6

Distributional Effects

Table 2 highlights the distributional impacts of the tax change in 2021. On average, only those filers with income in the 95th percentile and above would see a tax cut. Those in the top 1 percent of income would receive 98 percent of the total tax cut while those in the top 0.1 percent would receive 75 percent of the total benefit. Households in the top 0.1 percent with capital gains or dividend income (91 percent of these households) will see their tax liabilities decrease by just over $200,000 on average.

Table 2. Distribution of Federal Tax Change, Calendar Year 2021

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Including corporate income tax burden

Income Group	Average Tax Change	Share With A Tax Cut	Average Tax Cut for Those with a Tax Change	Percent Change In After Tax Income	Share Of Tax Change	Share Of Federal Taxes Paid	
						Before Tax Cut	After Tax Cut
Bottom quintile	$0	0%	$0	0%	0%	0.1%	0.1%
Second quintile	$0	0%	$0	0%	0%	3.0%	3.0%
Middle quintile	$0	0%	$0	0%	0%	10.5%	10.6%
Fourth quintile	$0	0%	$0	0%	0%	18.9%	19.1%
80-90%	$0	0%	$0	0%	0%	14.7%	14.8%
90-95%	$0	0%	$0	0%	0%	10.9%	11.0%
95-99%	-$115	8%	-$1,455	0%	2%	16.3%	16.4%
99-99.9%	-$6,625	76%	-$8,675	1%	23%	12.7%	12.6%
Top 0.1%	-$191,550	91%	-$211,700	3%	75%	12.8%	12.2%

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