

Who Pays Capital Gains Tax?

By Eric Toder

The taxation of capital gains has once again become an issue in the presidential campaign. Presumptive Democratic presidential nominee Sen. Barack Obama of Illinois has proposed to reverse most of the cut in capital gains taxes since 1997 for individuals in the top two rate brackets, increasing the rate from 15 percent to 20 percent or more. Presumptive Republican presidential nominee Sen. John McCain of Arizona has claimed that higher capital gains taxes would affect millions of middle-income Americans.

Fewer than one in seven individual taxpayers report taxable capital gains in any year. In 2006 just 13.4 million out of 138.3 million taxpayers reported taxable net gains (net long-term gains in excess of net short-term capital losses and capital gains distributions, which are taxed at favorable capital gains rates) on Schedule D, and another 4.6 million reported capital gains distributions from

mutual funds on their Forms 1040. Many taxpayers with gains had modest incomes — more than half (52 percent) of those with taxable net gains or capital gains distributions had incomes below \$75,000. But high-income taxpayers accounted for the overwhelming share of capital gains (Table 1). The 3 percent of tax returns with adjusted gross income exceeding \$200,000 reported 31 percent of AGI and 83 percent of capital gains. The 0.3 percent of returns with AGI exceeding \$1 million reported 15 percent of AGI and 61 percent of capital gains. Capital gains represented less than 4 percent of AGI for gains recipients with income less than \$200,000, but about 40 percent of AGI for those with income exceeding \$1 million.

Many more Americans accrue capital gains on corporate shares they hold within tax-deferred employer-sponsored retirement saving plans or individual retirement accounts. But capital gains from stock sales within those accounts are not subject to capital gains tax. Accruals within those accounts are tax free until distributed and then are taxed as ordinary income.

Table 1. Distribution of Capital Gains by Adjusted Gross Income (AGI), 2006*

AGI in Dollars	Percent of Returns	Percent of AGI	Percent of Capital Gains	Returns With Capital Gains	Gains as Share of AGI
<75,000	80.3%	36.8%	6.2%	8.5%	1.8%
75-200,000	16.8%	32.0%	11.2%	27.1%	3.6%
200,000-1 million	2.7%	16.1%	22.0%	53.9%	13.5%
1 million and over	0.3%	15.1%	60.6%	76.3%	39.5%

*Calculated as sum of net capital gains on schedule D plus capital gains distributions reported only on 1040. Excludes short-term gains taxed as ordinary income.

Source: IRS Statistics of Income, Individual Income Tax Returns, 2006, Table 1.4 and author's calculations.



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