

Contents

List of Tables and Figures	xi
Preface	xiii
Acknowledgments	xv
1 Overview	1
Some Illustrations from the Policy Debate	1
Sorting Out the Issues	3
What's to Come	5
2 Should We Tax Income from Capital?	11
Taxation of Capital Income and Savings	14
Capital Income Taxation and Economic Efficiency	29
Distributional Issues	44
Administrative Issues	48
Summary	49
3 Is The Capital Income Tax Structure Efficient?	51
Deviations of the Current Tax from Neutral Taxation	52
Justifications for Nonneutral Taxation	60
Summary	73
4 The Efficiency Cost of the Corporate Tax	75
Distortions Arising from Corporate Taxation	76
Policy Options	90

- 5 Tax Neutrality and Capital Cost Recovery: Depreciation, Inflation, and Investment Subsidies 95**
 Measuring Income Correctly 98
 Investment Subsidies and Penalties 107
 Investment Incentives as Countercyclical Devices 118
 Conclusion 120
- 6 Capital Gains Taxes 123**
 Sources of Capital Gains 126
 Effective Tax Rates on Capital Gains 130
 Measuring the Lock-in Effect 136
 The Capital Gains Tax and Economic Efficiency 141
 Equity Issues 151
 Policy Options 154
 Summary 159
- 7 The Corporate Alternative Minimum Tax and the Passive Loss Restriction 161**
 How the AMT and Passive Loss Restriction Work 162
 Roots of the AMT and Passive Loss Restriction 164
 Efficiency Issues 167
 Equity Issues 175
 Policy Options 176
- 8 Tax Treatment of Retirement Savings: Pensions, IRAs, and Other Tax-Deferred Savings 179**
 An Overview of How Retirement Plans Work 181
 Effects of Tax Treatment on Marginal Effective Tax Rates 185
 Efficiency Issues 186
 Equity Issues 198
 Possible Revisions in Tax Treatment 200
- 9 A Potpourri of Capital Income Tax Issues 203**
 Housing and the Deductibility of Consumer Interest 203
 Intangible Capital 206
 Tax Treatment of the Extractive Industries 210
 Tax-Exempt Bonds 212

Special Types of Businesses	215
Tax Incentives for Small Businesses	220
Geographically Targeted Tax Incentives: Enterprise Zones	221
Miscellaneous Provisions	222
10 Capital Income Taxation in an International Economy	225
The Myth of "International Competitiveness"	226
Issues of International Taxation	227
11 Economic Analysis of Capital Income Taxation and Tax Policy	245
Moving toward a More Efficient Tax System	245
The Tax Policy-making Process	252
Appendix A: History of Capital Income Taxation in the United States	261
Appendix B: Methods of Calculation and Data Sources	287
Notes	303
References	311
Index	331

List of Tables and Figures

Tables

- | | | |
|-----|---|-----|
| 2.1 | Data used to estimate marginal effective tax rates | 20 |
| 2.2 | Distribution of family income by source | 44 |
| 2.3 | Distribution of family income by age | 47 |
| 3.1 | Marginal effective tax rates (firm level) by broad asset type | 54 |
| 3.2 | Marginal effective tax rates: Structures and equipment, 1986 and present | 55 |
| 3.3 | Marginal tax rates and corporate/noncorporate tax wedges | 56 |
| 3.4 | Marginal effective tax rates: Debt and equity finance | 59 |
| 5.1 | Marginal effective tax rates: Structures and equipment, varying inflation rates | 109 |
| 5.2 | Marginal effective tax rates with investment incentives | 110 |
| 6.1 | Individual capital gains by asset type | 129 |
| 6.2 | Effective tax rates on capital gains: Corporate stock | 131 |
| 6.3 | Effective tax rates on capital gains: Structures | 135 |
| 6.4 | Increase in return necessary to sale: Corporate stock | 137 |
| 6.5 | Increase in return necessary to sale: Corporate stock, held until death | 139 |
| 6.6 | Increase in return necessary to sale: Structures | 140 |
| 6.7 | Revenue effects and welfare gains from capital gains tax cuts | 149 |

6.8	Increase in appreciation necessary to sale: Corporate stock, exclusion equivalent to indexing a seven-year asset	155
7.1	Marginal effective tax rates: Regular and minimum tax	169
7.2	Effect of the tax reform act of 1986 on rents: Tax shelter model	173
10.1	After-tax rates of return, assuming 10 percent pretax return, with high-tax (50 percent) country A and low tax (25 percent) country B	229
A.1	Major tax legislation and common acronyms	284
B.1	Estimated marginal effective tax rates	294
B.2	Asset lives: Equipment and structures	296
B.3	Investment credit rates: Equipment and structures	297
B.4	Cost recovery rules and capital gains exclusions	298
B.5	Economic depreciation, minimum tax lives, and asset shares	299
B.6	Distribution of capital stock by industry, sector, and broad asset type	300
B.7	Savings rates and estimated rates of return	301

Figures

2.1	Estimated marginal effective tax rates	22
2.2	Savings rates and estimated rates of return	26