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CBO CONCLUDES THAT CAPITAL GAINS TAX ACTIVITY IS NOT LINKED TO RATE CUTS

Dear Colleague:

Recently, Treasury Secretary John Snow and others have called upon us to extend the tax cuts for capital gains and dividend income. As you know, these lower rates do not expire until January 1, 2009, which occurs during the *next* President's term. One argument from proponents is that these cuts encourage a great deal of selling by investors, so much so that these cuts pay for themselves.

However, last week in a letter to Finance Committee Chairman Grassley, the CBO found that, "[I]ncreases might suggest a large behavioral response to the tax rate cut -- except that realizations also increased by 45 percent in 1996, before the rate cut. Thus changes in realizations are not necessarily the result of changes in taxes; other factors matter as well." CBO explained that asset values, investor decisions, and other economic conditions can influence capital gains realizations just as much. (For the full letter, see http://www.cbo.gov/ftpdocs/70xx/doc7047/02-23-CapitalGains.pdf.)

In fact, CBO not only examined the year following the 2003 tax cuts, but they dug even deeper and did a historical analysis of capital gains cuts. The CBO experts found that, "[a]fter examining the historical record, including that for 2004, we cannot conclude that the unexplained increase [in realizations] is attributable to the change in the capital gains tax rates." CBO concluded that much of the volatility in capital gains realizations "seems unrelated to changes in the capital gains tax rates."

Before we rush to commit $50 billion to extend provisions that do not expire for three more years, perhaps we should listen to our own experts who are debunking the main selling points for some of these tax cuts.

Sincerely,

John F. Kerry

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