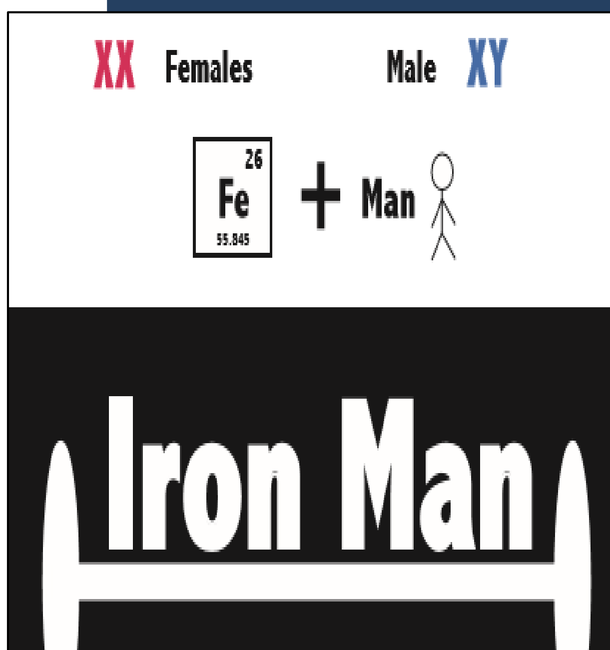
2016

Capital Gains at Lower Rates than Earned Income?

Persuasion and Argumentation

24 March 2016



Elisabeth Aubrey, Anita Blatnik
Eli Hughes, Megan Ringwell,
Erica Ropson & Emily Vorpagel

Table of Contents

Executive Summary

Capital gains tax has been a controversial topic over the years. To gain a better understanding of this topic, two audiences were selected: Green Bay, Wisconsin residents and Wall Street Journal readers. As always, there are two sides to each argument. For the purpose of this case, the Green Bay audience was determined to have a slightly more liberal than conservative sway, while the Wall Street Journal audience was determined to have a highly conservative sway. Two sides of this argument have tried to argue effectively towards these audiences: the affirmative side which argues capital gains taxes should go up and the negative side which argues they should remain the same. A series of Toulmin models were constructed to further understand each argument and to help break down which arguments had the strongest impact for each audience. After each argument was ranked, the affirmative side was declared the more effective arguers, the losing side was given tips on how they could make their arguments more impactful by arguing towards the resistant audience.

Case Overview

Background

In January 2016, President Obama drafted a proposal that would raise $320 billion over the next ten years. The funds would allow for $235 billion in tax breaks for moderate income Americans, as well as the pursuit of "other initiatives," unspecified.

The proposal calls to increase levies on high-income Americans. More specifically, Obama has proposed to raise the capital gains tax rate to match the income tax rate. Though he has proposed other methods to obtain the $320 billion, raising the capital gains tax rate is among the most controversial methods.

Our Purpose

The purpose of our assignment is to analyze the arguments made by both sides responding to the question, “Is it fair to tax capital gains at a lower rate than earned income?” We were given an article entitled, “Is It Fair to Tax Capital Gains At Lower Rates Than Earned Income?” to have some of the main arguments made by each side pointed out to us. In the article, writer Leonard Burman represents the affirmative side, and writer Scott Sumner represents the negative side.

Affirmative & Negative

As implied in the *Background*, capital gains are currently taxed at a lower rate than earned income. As discussed in the *Background*, President Obama is proposing to raise the capital gains tax rate to match the income tax rate, so he is endorsing a change. Because he is endorsing a change, Obama stands on the affirmative side of the dispute. Obama, Leonard Burman, and others on the affirmative side are considered to be taking a liberal stance on the issue.

On the other side of the fence is the negative stance. A negative position means that the disputant advocates the status quo. In this case, the status quo is keeping the capital gains tax rate lower than the income tax rate. Scott Sumner and others advocating the negative side are considered to be taking a more conservative position on the issue.

Before Going Further

"Capital gains" is not a topic that most people, we conjecture, bring up at a garden party. Understanding capital gains takes time. For our readers' convenience, we have highlighted "the basics" of what needs to be known about capital gains before reading the rest of this paper.

What is a Capital Gain?

The best way to explain what a capital gain is, is by example. Consider, for instance, that Laurey built a house in 2003 for $120,000. In 2013, Laurey sold her house for $220,000. On the sale of her house, Laurey made $100,000 profit ($220,000 - $120,000 = $100,000). This $100,000 is considered a capital gain (Investopiedia, 2016). (Appendix G.)

Using the same example, suppose that Laurey did not sell her house, but only got her house *appraised* at $220,000 in 2013. Because this is only a "would be" scenario, the $100,000 difference—between the amount Laurey built her house for in 2003 and the amount Laurey's house is appraised at in 2013—is not defined as a capital gain. In other words, a capital gain is only recognized as such when a profit is real, not hypothetical (Investopiedia, 2016). (Appendix H.)

Types of Capital Gains

There are many types of capital gains. Equities, dividends, stocks, bonds, mutual funds, and IRAs are just a few. First, equity is defined as an asset minus liabilities. For instance, if I have a $15,000 car (asset) but I owe $5,000 (liability) on it, my equity is $10,000. (Appendix I.) There are also different types of equities, such as long term equities, existing longer than one year, and short term, existing for less than one year. Long term equities are taxed at lower rates than short term equities. Second, **dividends** are a distribution of a portion of a company's earnings. Third are **stocks**. You may have heard of common stocks and preferred stocks. Fourth are **bonds**. A bond becomes a capital gain if it is sold before maturity and a profit is made off of the sale. Municipal bonds are unique in that they are not taxed at the federal, state, or local level, but the tradeoff to that is they generally pay lower yields. Next, a **mutual fund** is made up of a pool of funds collected from many investors. Together, the investors invest in securities such as stocks, bonds, money market instruments, and similar assets. Lastly, an "**IRA**" is an individual retirement account. IRAs are tax free (Investopiedia, 2016).

There are many types of capital gains, and different capital gains are taxed at different rates—So what? When we talk about raising the capital gains tax rate to match the income tax rate, we are talking about raising the *overall* revenue the government receives from capital gains as a result of the tax levy. Specifically, President Obama's proposal is to raise the capital gains tax rate which is currently at 23.8% to 28%. Furthermore, Obama's proposal, put explicitly, is to raise the capital gains tax to this rate for only the top one percent of taxpayers.

Audience Analysis

In addition to analyzing the arguments made by both sides we were asked to understand, dissect and rank the strength of these arguments with two audiences in mind: Green Bay residents and readers of the Wall Street Journal. In the end, we will determine which side "wins over" the Green Bay residents and the Wall Street Journal readers, collectively, the best. We will also describe how the loser could have appealed to his audiences better.

Analyzing the Green Bay audience first, we know that Green Bay is almost a perfect liberal-conservative split, with conservatives making up approximately 52% of the population and liberals making up approximately 48% of the population. These percentages are based on information received from Wisconsin Representative Tyler Vorpagel. Furthermore, we know that Green Bay residents are mostly considered lower middle class, and we know that there are quite a few business owners in the area.

We can infer (at large) that the conservatives will side with the negative case, and the liberals will side with the affirmative case. Because we can infer that our Green Bay audience will be split on the issue, it is important to explain the benefits *and* the costs of raising the capital gains tax rate. Additionally, we know that arguments should not focus on just the financially “wealthy” or just the financially “poor” perspectives, and, with that, arguments should not be as much about conservative v. liberal as much as logic.

Second, we know a lot about Wall Street Journal readers (at large). First, we know that they are business focused, sway conservative, and are mostly upper middle class. From this, we can infer that they prioritize business success. We can also infer that their approach to economic policies, like their approach to most other political concerns, are conservative.

To win over Wall Street Journal readers, Sumner and Burman need to demonstrate how the proposal to raise the capital gains tax rate can *help* businesses. Plus, both sides should avoid framing the need as “to raise government revenue.” With this, they should not talk about raising taxes for high-income individuals unless they, too, are going to receive tax breaks. Lastly, they should not downplay the impact the change could have on businesses.

NRDd

As described in the *Background* sub-section of the *Case Overview*, there is a foreseen **need** for money: $320 billion over the next ten years. The money would allow for $235 billion in tax breaks for moderate income Americans, as well as the pursuit of other initiatives.

The **remedy** for this need is increasing levies on high-income Americans. Though there are many proposed methods for this initiative, one of the most controversial schemes is raising the capital gains tax rate to match the income tax rate. That would raise the capital gains tax rate from what it is now, 23.8% to 28%, and is the central focus of our debate analysis. Also noteworthy is that the proposal calls to raise the capital gains tax rate only *for the top one percent of taxpayers*.

The negative side says that the focal **disadvantage** to the affirmative side's remedy is that the request could cause fewer investments, ultimately harming the economy. The affirmative side agrees to an extent, but in the Affirmative sub-section of Arguments, we will go over how the affirmative side addresses this disadvantage.

Last of all, the affirmative side says that the underlying **devil** is the unequal distribution of wealth. Furthermore, they make tax shelters into a second devil. Tax shelters occur when a taxpayer reclassifies a piece of income as a capital gain so that the taxpayer can benefit from a lower tax rate; this is a legal practice.

Arguments

In the process of breaking down this case, we found that both the affirmative and negative case were built around a few key arguments. These arguments were picked out based on their effectiveness and importance to the case. In some instances we selected the arguments with the strongest effect on the audiences in question, while at other times we chose the arguments which were most referenced throughout the case. Iron Man has created a Toulmin model representing these primary arguments and how they relate. While these primary arguments formed the foundation of our analysis, the other ancillary arguments were also considered.

Each of these arguments were divided into the categories of *logos*, *ethos* and *pathos* based on their warrants. During the process of categorizing them, we did find that some arguments seemed to be one form of warrant on their surface, but had an impact similar to another. Warrants based in logos could have an underlying flavor of ethos or even pathos appeals. We found this to be useful for considering how each argument affects both audiences, which was vital for determining effectiveness as covered in the Effectiveness section. Those specific arguments and categorizations helped to gain a better understanding of the affirmative and negative sides of this case.

Affirmative Case

Three arguments form the core of the affirmative case, two of which are closely interrelated. The Toulmin model in Appendix C illustrates the relationship between the main affirmative claim (capital gains should be taxed at the same rate as normal income) and three pieces of evidence.

The first piece of evidence (shown on the right side of the Toulmin model in Appendix C) is the part of the argument that is used by the affirmative case to demonstrate a need for change. They state that the rich get a disproportionate benefit from capital gains tax, with the motivational or pathos warrant being that since this is an unfair situation, capital gains tax should be raised.

With this need established, the next most important piece of the affirmative case is the evidence shown on the far left of the Toulmin model in Appendix C. This evidence is that Reagan's tax reform plan, instituted in 1986, increased capital gains tax among other changes, and did not negatively impact investments. The warrant is drawing a parallel between this historical example and the affirmative side's proposal to fix the problem, which involves three elements that were also present in the Reagan tax plan: raising capital gains tax, reducing other tax breaks, and cutting income taxes. Since this has worked in the past without damaging investments or the economy, a similar proposal should similarly feature no damage to investments (thus showing the relative lack of disadvantage in their proposal).

This warrant supports the claim that capital gains tax increases will maintain investments, which is then in turn used as evidence supporting the main claim that capital gains should be taxed normally. Since investments drive the economy, maintaining investments is an important goal and therefore capital gains should be taxed. These two linked arguments serve as a counter-argument to the negative case's main argument that capital gains help drive the economy.

While the parallel case argument about Reagan's tax reform at first appears to be a straightforward logos argument, in effect, it is similar to an ethos argument. To understand how and why, it is necessary to consider that Reagan is a very well respected conservative politician whose name has a powerful authoritative impact with those who support conservative economic policies. Additionally, the time of Reagan's presidency and the years following are often looked at very favorably as years of economic stability and growth. So by invoking the name of Reagan, and the almost emotional attachment to the period of his presidency, the argument has a strong ethos effect, even though it is based in a logos warrant. Similarly, even the warrant stating that maintaining investments is desirable, while founded in logos, has an undertone of pathos appeal. The motivation of driving the economy is underlying value that it is presumed that the audience shares.

In addition to this core set of arguments, the affirmative side makes a number of supporting arguments (the arguments in Appendix E with effectiveness ratings next to them), which, together with the main arguments, make up the overall case. As you can see in Appendix E, most of the affirmative case features logos appeals, but they still use pathos appeals to establish the devils (unequal distribution of wealth and tax shelters) and the ethos/logos appeal discussed above to counter one of the negative case's main points. Of the remaining logos arguments, two support the pathos appeals in creating the devil, three are related to the implementation of the suggested plan (based on Reagan's tax reform) and one more is a counter-argument to the negative's claim that inflation has a disproportionate effect on capital gains. These are all supporting arguments to the foundation of the Toulminized arguments discussed just above.

While the affirmative side does acknowledge and counter many arguments from the negative case, they also fail to fully address several areas. While the affirmative arguer briefly acknowledges the negative side's argument that double taxation is unfair, they then artfully sidestep the value of that statement. Instead of debating the fairness or the truth of that argument, they shift the focus off of capital gains alone to a plan for large-scale tax reform.

One other argument is ignored by the affirmative case completely. The negative side argues that indexing all capital income and expenses would be extremely complicated and would entail math that even most smart individuals would have trouble handling. This potential counter-argument either wasn't considered or couldn't be properly refuted by the affirmative side, seeing as it is not mentioned in the affirmative case.

Negative Case

Like in the affirmative case, we have illustrated the two main arguments from the negative side of the case in the form of a Toulmin model (Appendix D). On the right side of the Toulmin, you can see that the negative side is stating that capital gains are taxed twice. Expanding on that summary of the evidence, they say that since most investments are made out of your income after it has been taxed once, when it's taxed again (after selling the investment and receiving a capital gain) it's actually a case of double taxation. The pathos warrant here is that since double taxation is inherently unfair raising capital gains tax would be more unfair and is therefore a bad idea.

The biggest piece of the negative case, which many of their arguments are related to, is that capital gains tax breaks drive investments. This is the part of the argument depicted on the left side of the Toulmin model in Appendix D. The claim is that low capital gains taxes make investors more money, which is linked to the main claim by a logos warrant: since the more money investors can make, the more they are willing to invest, and investments drive the economy, capital gains tax should remain low.

There were a number of ancillary arguments to consider as well. Three of them, all logos appeals, relate to the point that the way inflation affects capital gains means that the tax should remain low. The other argument that hasn't already been discussed supports the point that capital gains drive investments by adding a value to it, stating that investments in certain industries benefit all of us through cures for diseases and innovations. Combining these with the Toulminized arguments already discussed, we get the overall negative case (Appendix F).

Some elements of the affirmative case were predicted and countered in the negative case, but there is one major exception. The affirmative side does provide evidence that capital gains are not necessary to drive economic growth with the Reagan tax reform argument (which will be explained fully in the Affirmative sub-section). This counter-argument is not anticipated by the negative side and goes unaddressed. In addition to this oversight, the negative side failed to offer up much support for the claim that there is a correlation between capital gains and investments.

Effectiveness

For the purposes of evaluating this case, we have defined effectiveness as a potential to reach and persuade members of *both* primary audiences that we were provided with (Green Bay, Wisconsin and the Wall Street Journal readership). We chose this since arguers have to keep in mind all audiences they are addressing with their case, so combining their effectiveness for both audiences into one ranking seemed like the most appropriate way to reflect that reality.

Using this definition we ranked each of the arguments presented by the authors on a scale of 1 to 10, with 10 being the most effective, starting with the primary argument sets described in the Arguments section and depicted in Appendices C and D.

We ranked the affirmative case's main arguments as an 8. This set of arguments was effective because it does a good job of presenting persuasive ideas to both audiences. The argument pointing out the unfair distribution of wealth is something that is very likely to resonate with the Green Bay Audience, since it is a lower middle class city. On the other end of the Toulmin, we see an argument that has a strong ethos and logos appeal to the readers of the Wall Street Journal, who are largely conservative. The ethos appeal of this argument is tied in with the fact that it is similar to reluctant testimony. It is a historical example of a very respected conservative politician enacting a liberal economic policy. For the same reasons that reluctant testimony is preferable, this "reluctant policy" by Reagan adds to the effectiveness of this argument.

The primary set of negative arguments was slightly less effective, with a score of 7. It also argues well for both audiences. The double taxation argument has a broad appeal and will impact both audiences, since nobody wants to be taxed twice. Even though it has a general appeal, it may have a slightly stronger impact on the higher income Wall Street Journal audience (since they're more likely to get more of their income from capital gains). On the other side of the negative Toulmin, the argument stating that low capital gains tax drives investments should be very persuasive for the Wall Street Journal readership. That audience tends to hold economically conservative viewpoints, and the idea of cutting taxes drives investments and therefore the economy is right in line with classic conservative economic policy. Since this should align closely with beliefs they already hold, the Wall Street Journal audience will most likely find this to be a compelling argument.

With the main arguments rated so closely in effectiveness, we then looked at the arguments as a whole by also rating the ancillary arguments (Appendix E and F) and then considering the cases in their entirety. Each of these additional ratings were made using the same definition of effectiveness defined above. Most arguments were middling in their effectiveness, with a few notable exceptions.

On the negative side, notable arguments include the claim that lower capital gains taxes will result in more cures for diseases and better inventions. This is a motivational warrant which has good appeal to both audiences. It is tied in with the core argument that lower taxes will drive investment and therefore aligns with beliefs of the Wall Street Journal audience, and features a pathos element which should have a stronger impact in the Green Bay audience. At the other end of the spectrum, we have the very lowly rated argument that even college educated people won't be able to handle the complexity of indexing all investments. This argument could have been potentially rated higher, but the audiences- especially the more educated Wall Street Journal audience- may find the phrasing to be insulting to their intelligence.

The affirmative side also had two notable supporting arguments, both dealing with the support and creation of the tax shelters devil. They state that capital gains are the catalyst for tax shelters, and then that capital gains therefore misdirect scarce resources into nonproductive activities. These arguments were both rated as a 7 since they are logos appeals which are backed up by the evidence and will impact both audiences. On a more personal, business focused micro level, this should be persuasive for the Wall Street Journal audience (this money is being taken out of the economy and misdirected where you can't earn any of it) and on a broader, societal macro level it has appeal to the Green Bay audience (this money would be better served benefitting society and it is being kept away from the population by the activities of the wealthy).

Overall the scores for both cases were again very close. By considering and weighing the importance of each ranked argument, we boiled down each side to one score, hoping to see a clear winner. After this process, the affirmative side received a 7, while the negative side received a 6, which was again very close and does not demonstrate an obvious victor in this case.

Winning the Case

Given the close scoring of each case's effectiveness, we decided to base the winner off of which side gave the single most compelling argument for both audiences. Ultimately we found the affirmative side to have the more effective case, due to their effectiveness in presenting persuasive arguments for both audiences, especially the more resistant audience.

Both sides of this case made compelling arguments for the Wall Street Journal audience. Since this is a more educated audience, the heavy use of logos warrants by both sides means was an effective means of reaching them. Additionally, the negative side used arguments which align with the preconceived notions of this audience, and the affirmative side used a very powerful ethos/logos appeal.

Despite the fact that both sides argued in ways this audience will find compelling, we determined that the affirmative side's arguments for this audience were much more important. The negative side may have been very compelling towards this audience as well, but this was the audience that was *already likely to agree with them* going into the argument. As an economically conservative, business focused, high income audience, the readers of Wall Street Journal are the audience that will show more resistance or push-back towards the affirmative case. Given this, the fact that the affirmative side was able to argue convincingly for this audience is worth much more than the negative side's efforts towards the same set of people.

Meanwhile the negative side failed to mount a single argument that was as effective at arguing towards the (resistant) Green Bay audience as the affirmative side's Reagan argument was at arguing towards the Wall Street Journal audience.

This difference in convincing the resistant audience is ultimately what decided the case. Both sides had a similar overall level of effectiveness, but the affirmative side's ability to persuade the resistant audience means that they got more "bang for their buck" with their case overall. Iron Man decided that it is worth more to convince your detractors than it is to get your supporters nodding along in agreement.

Suggestions for the Loser

Based on the arguments presented by both the affirmative and negative side, the negative's arguments were weaker for targeting both audiences. Iron Man suggests that the negative side should attack the strongest argument that the affirmative side presented (in this case, the Reagan tax reform argument that was covered in the Affirmative sub-section of *Arguments*). To strengthen the negative side's argument they need to show where the affirmative side went wrong.

The affirmative side makes creating a tax reform sound simple, and only shows the positives of the change. The negative needs to show that implementing the tax reform is not easy. To do this they need to demonstrate the difference between the era when the Reagan Tax Reform was created, and now.

Iron Man found that there are both political and economic changes that have occurred. The negative side needs to explain that Reagan was well supported by the people and had a cooperative congress. His ideas on the tax reform were respected partially because Reagan was good at showing both sides of the issue. Today, there is less cooperation between political parties.

Taxes affect everyone which leads to multiple perspectives on how to handle future tax reforms. This creates a challenge when deciding what is the best approach, which will most likely bog down the legislative process, making it unfeasible. The negative side needs to bring this up as one of their arguments. They need to show that these changes are not as cut and dry as the affirmative side is trying to make it sound.

In addition to attacking the affirmatives side's strongest argument, another suggestion is to gain support from the resisting audience. The negative side provided wonderful evidence for those who are persuaded by logos warrants. However, not everyone is persuaded by them.

The negative side needs to include more motivational (pathos) and authoritative (ethos) warrants. This allows for a wide variety of options to gain support from every audience.

Overall the negative side did incorporate strong arguments for the audience that already supported them. However, the tips Iron Man is suggesting will gain support from the resisting audience as well.

Rejected Solutions

Iron Man debated on presenting the Toulmin model for every argument. Strategically, we decided to Toulminize the arguments that we found were most effective for both audiences. Another rejected solution was to preemptively decide a winner. We were tempted to choose a winner before looking at the Toulmin model for every argument on each side. This would have been skipping a lot of strategy. Iron Man wisely decided to wait and look at all the Toulmin models before deciding which side was the winner.

So What?

The process of making numerous Toulmin models helped us look at the best and the strongest arguments for the resistant audience, which in this case were made by the affirmative side of the argument. The Toulmin models also helped us to see that arguments can be more than just one type of argument (logos, pathos, and ethos). For example, an argument that has a logos focus can also have “undertones” of a pathos argument. We found that several of the arguments within the case focused on more than just one type of argument. We concluded that it is not the number of arguments made, but the strength of the Toulmin models for the argument. We also constructed a “So What?” math equation which is: Toulmin Models X Audience Analysis= An Effective Argument for the resisting audience.

Continuous Improvement

Moving forward, we wish to have a better understanding of the micro and macro perspectives in this case. Instead of basing the winner off of macro level perspective, which is what we did by deciding one winner of the case for both audiences, we could have considered basing the winner on a micro level perspective. By zooming in on which arguments would resonate with the specific target audiences, we could have argued that there were different winners for both the affirmative and the negative sides for this case. For example, Green Bay’s political majority was close to a 50/50 split. By taking a deeper dive into audience analysis we could have had a better understanding as to which arguments were the strongest for each micro-group of the Green Bay audience.

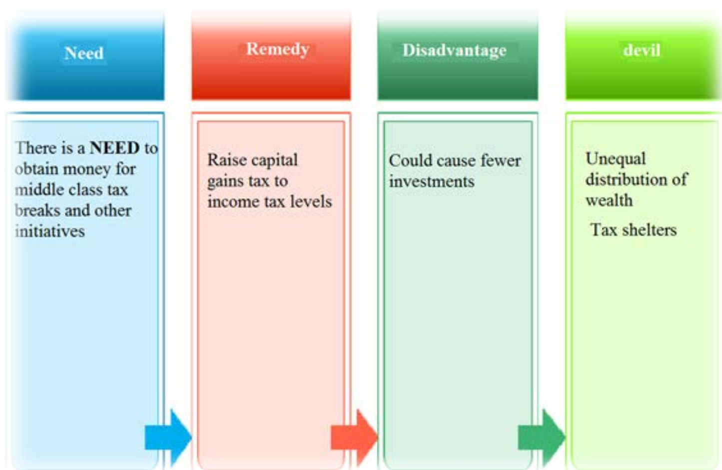
To go along with analyzing the micro and macro audience analysis perspectives, we could have also touched on micro and macro perspectives on how capital gains tax would affect each audience differently. The micro perspective of that would be, “How is this going to affect me as an individual?” and the macro perspective would be, “How is this going to affect the nation?” Both points would have been interesting to embrace during our case.

Appendix

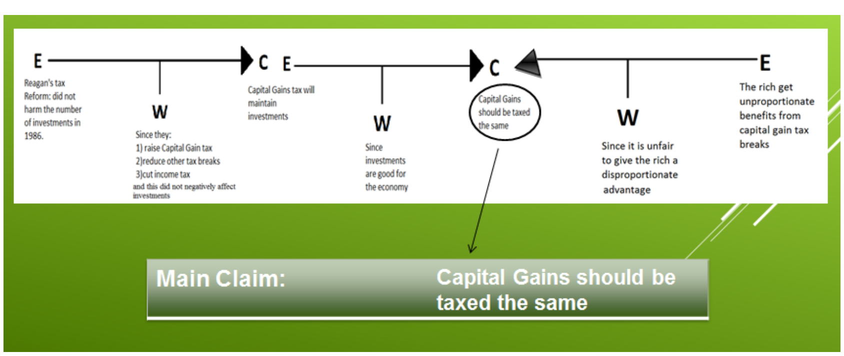
Appendix A: KISS Chart

Audience	Know	Infer	So what to do?	So what not to do?
Green Bay Residents	•52% Conservatives •48% Liberals •Lower Middle Class •Business Owners •Average income per household: $52,392	•Conservatives want no change (different rates) •Liberals want Capital tax raised	•Explain the benefits and costs of raising capital gains tax	•Focus on the wealthy •Pick a political side •Conservative vs. Liberal
Wall Street Journal	•Conservative Sway •Upper Middle Class •Business Focused •Dow Jones followers •Average income per household: $234,900	•Prioritize business success •Traditionally conservative economic policies	•Demonstrate how business can be helped with change	•Frame issues as way to raise govt' revenue •Downplay importance of impact of potential change on business •Discuss raising taxes, unless they will receive large tax breaks from them

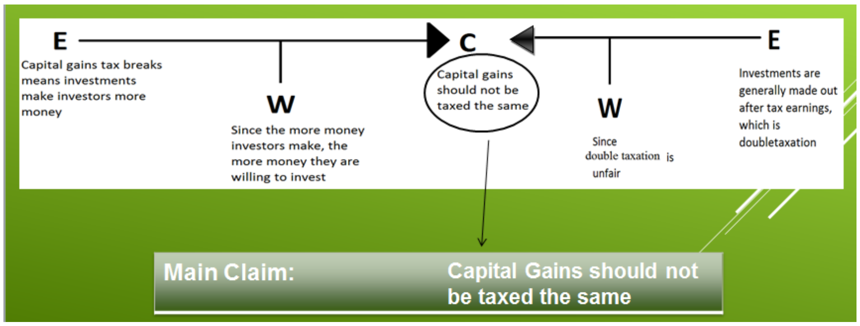
Appendix B: NRDd



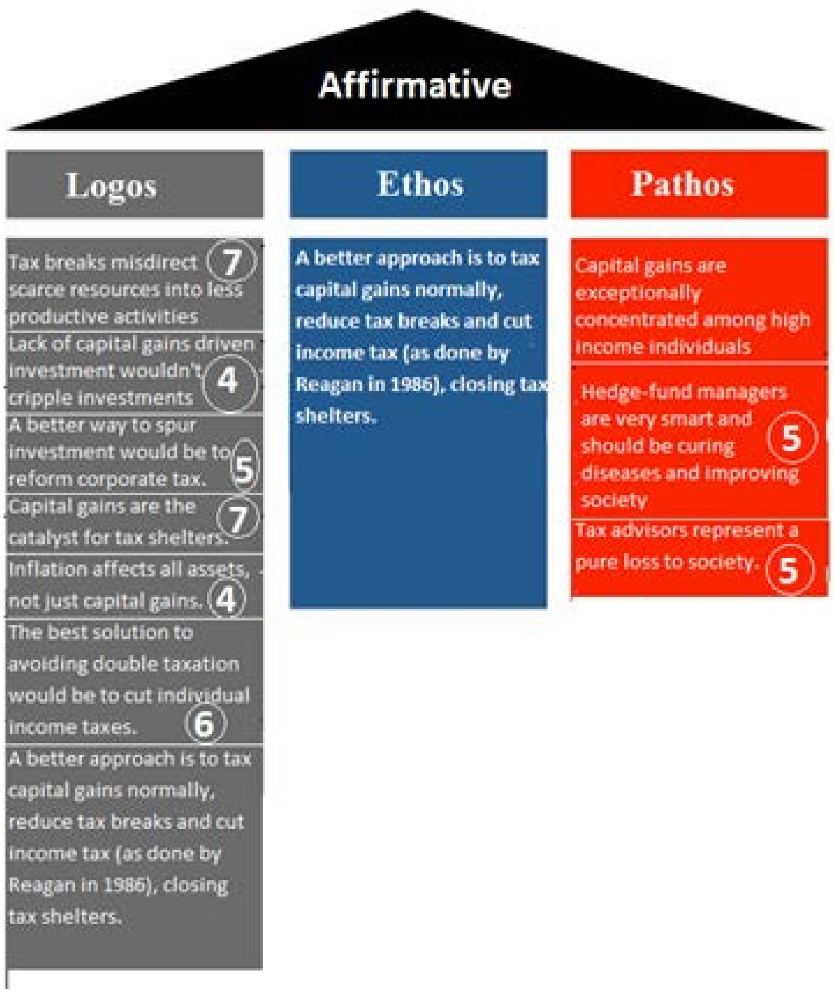
Appendix C: Affirmative Toulmin Model



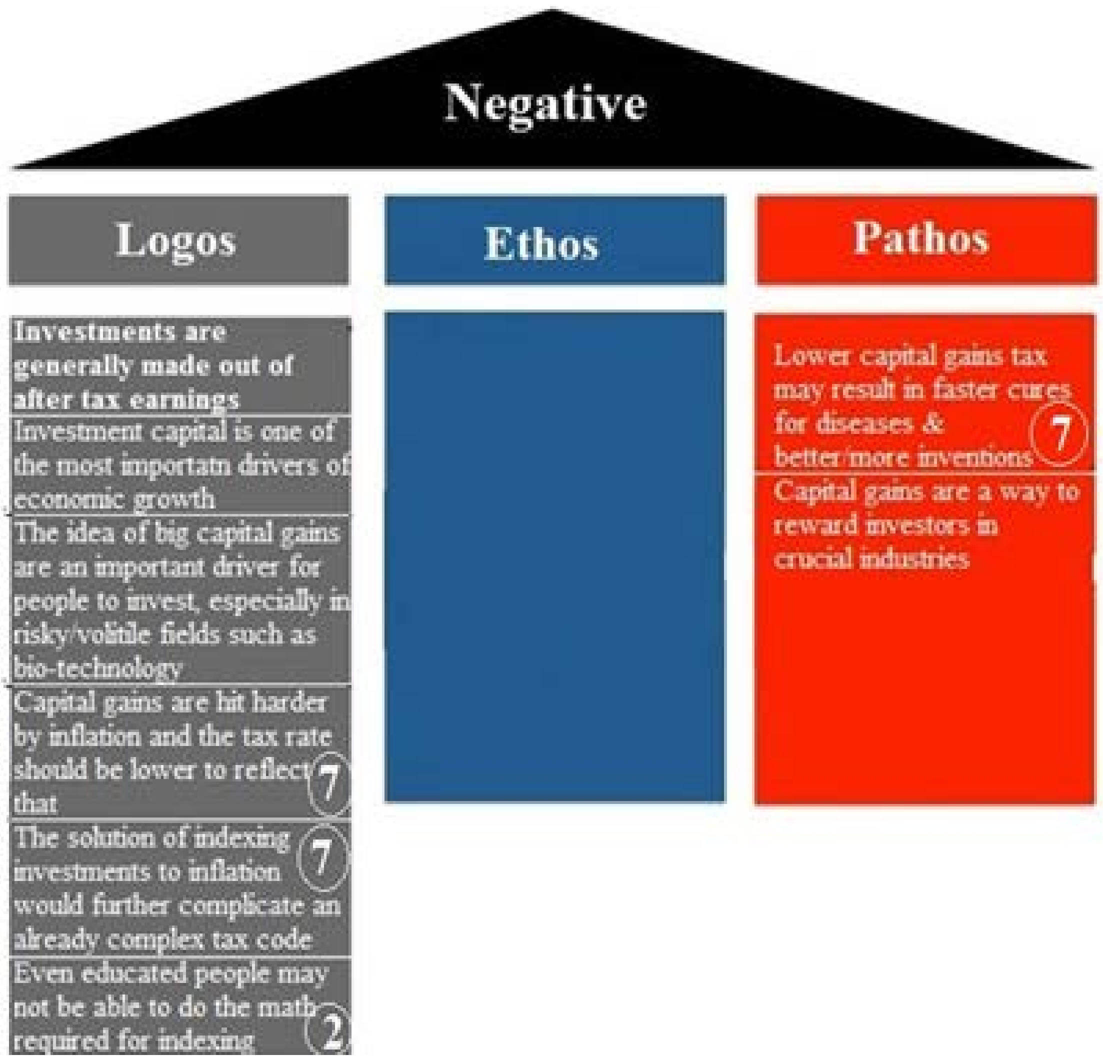
Appendix D: Negative Toulmin



Appendix E: Affirmative Arguments



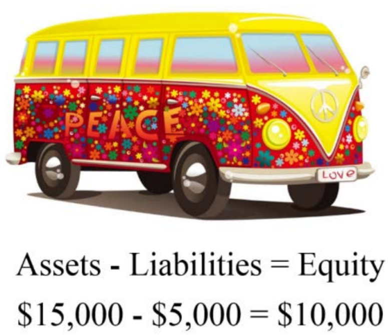
Appendix F: Negative Arguments



Appendix G: Capital Gain Example

Appendix H: Appraised Value Example

Appendix I: Assets - Liabilities Model



Appendix J: Agendas

2/3/16
1. Audience Analysis
2. Arguments

2/10/16
1. Audience Analysis
2. Breakdown Arguments (Pick them)
    a. Toulmin Model Ideas

2/17/16
1. NRDd
2. Toulmin Model

2/24/16
1. Look over Toulmin again
2. Affirmative vs. Negative

3/2/16
1. Final PowerPoint done
2. Practice Presentation

Appendix K: 100 Facts

<u>Advantages of Fair Tax Act</u>

1. Easier to estimate how much revenue will be made from taxes
2. Taxes what you spend not what your income level is
3. Money invested will increase (Read description on website)
4. Payroll Taxes will be gone
5. Taxes on investments and capital will be gone
6. Will help people manage their spending habits
7. No more filing taxes
8. Prebates (Description on website)

<u>Disadvantages of Fair Tax Act</u>

9. Lower class will be hit harder
10. Middle class will be hit harder
11. Fear of tax evasion
12. People will spend less
13. Tax deductions won't exist
14. State income will be burdened more (On website for details)
15. Costs of immigrants will increase

<u>Studies That Support the Fair Tax</u>

16. The Beacon Hill Institute calculated that the base for the Fair Tax would be 81% of 2007 GDP, or $11.2 trillion. A 23% sales tax would collect $2.6 trillion, which is $358 billion more than the income tax that it would replace.
17. GDP increase 7.9% in year 1 on up to 10.3% year 25
18. Domestic investment is 74.5% higher in year 1, on up to 65.2% higher in year 25.
19. Consumption drops slightly in the first two years (0.6% and 0.8%) but is 6% higher by year
20. 25. Spending is fueled by an average 1.7% increase in disposable income. (Source: Beacon Hill Institute, Summary of Recent Research)
21. Studies That Don't Support the Fair Tax (more on website)
    a. a) William Gale of the Brookings Institute noted that the Fair Tax rate of 23% would translate to a 30% sales tax. FairTax quotes that the tax would be "$0.23 out of every dollar spent". That means a $.77 item would have a tax of $.23 - or 30% sales tax. He adds that states would also have to abolish their income tax, since there would be no IRS to determine wages. This would add another 10% to the sales tax.

<u>Basic information about capital gains taxes</u>

22. Any profit gained from selling "capital assets" (stock shares, land, or businesses) is considered a capital gain.
23. Capital gains have been taxed at a lower rate than normal income tax for a long time.
24. Roughly half of all capital gains are from selling stock.
25. Part of capital gain is due to inflation.
26. Assets returning in the form of capital gains are *probably* riskier.
27. Taxpayers are sometimes allowed to deduct for capital losses.

28. These deductions are limited within a single year but can be carried forward.
29. Under 2011 law, taxpayers can use capital gains to deduct for $3000 of other income in addition to capital gains being taxed.
30. In 2013, 75% of the benefits for low taxes on capital gains went to millionaires.
31. A tax shelter is defined as investments “"in which a significant portion of the investor's return is derived from the realization of tax saving with respect to other income, as well as the receipt of tax-favored (or, potentially, tax-exempt) income from the investment itself'
32. Capital gain - when an asset is sold for more than the price it was purchased at, the difference in that amount is called a capital gain. It is not realized until the asset is sold.
33. A capital gain must be claimed on income taxes.
34. From usdebtclock.org:
35. How far in debt are we? As of 1/31/16 at 11:30AM:
    a. $18.964 trillion + for country
    b. $58,725/ citizen
    c. $158,526/ taxpayer
    d. $3.7 trillion + for U.S. federal spending (^$119%)
    e. $445 billion + for U.S. federal budget deficit
        i. federal budget deficit - difference between money Congress spends and money received by IRS
36. GDP (Gross Domestic Product) - monetary value of all the goods and services a country produces in a specific time period
    a. current for U.S. - $18.217 trillion +
37. Largest Federal Budget Items:
    a. Medicare/ Medicaid
    b. Social Security
    c. Defense/ War
    d. Income Security
    e. Net Interest on Debt
    f. Federal Pensions
38. Goal:
    a. Raise $320 billion over 10 years - mainly via higher tax levies (rates) on high-income Americans
    b. Use money to cover $235 billion in tax breaks
        i. for moderate-income workers, other initiatives
39. How will goal be reached?
    a. (the following, among other ways)
    b. increase capital gains tax rate from 23.8% to 28% for top 1% of taxpayers
    c. impose an additional capital-gains tax on many inheritances
40. What is the GOP?
    a. the Republican Party (“grand ole party”)
41. Narrowing the problem:
    a. Should capital gains be taxed at lower rates than earned income?
        i. What is the difference between capital gain taxes and earned income taxes?

        ii. How are the effects of capital gain taxes and earned income taxes different?

From Case:

42. Argument A: Republicans
    a. If investment income taxes are raised,
        i. harm to economic growth
            1. discouraging business investment
            2. when you discourage business investment, you hurt workers' incomes

    Scott Sumner:
        ii. would punish "those who put their money to work" (double-taxing effect)
        iii. would not just affect investors; the entire economy would be impacted
            1. "investment capital is one of the most important drivers of economic growth"
            2. promise of big capital gains is what incites people to put money into risky but critical fields
                a. e.g. biotechnology; search for cancer causes
            3. inflation hits harder (unlike other income because earned income is taxed as it is earned)
            4. Indexing investments to inflation?
                a. Bad idea. Too complex of math.
            5. Solution:
                a. tighten tax code to eliminate tax shelters
                b. progressive taxes with consumption instead
                c. ideals: 401(K)-type structure, where you can move your money around from one investment to the next without facing a tax liability until withdraw and spend
43. hedge fund manager - career; try to use many different strategies to earn an active return for their investors
44. tax shelter - "A legal method of minimizing or decreasing an investor's <u>taxable income</u> and, therefore, his or her <u>tax liability</u>.
45. Tax shelters can range from investments or investment accounts that provide favorable tax treatment, to activities or transactions that lower taxable income.
46. The most common type of tax shelter is an employer-sponsored <u>401(k) plan</u>."
47. Different types of capital gains are taxed at different rates:
    a. equities: assets - liabilities = equity
        i. types: short-term (less than one year) and long-term (more than one year)
        ii. long-term are taxed at lower-rates, to encourage investment in good companies
    b. dividends from investment: distribution of a portion of a company's earnings
        i. e.g. qualified dividends
    c. stock: signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings

            i. types: common, preferred
    d. bonds:
        i. interest payments are similar to dividends, but bonds are taxed differently depending on type
            1. e.g. municipal bonds - free of federal, state, and local taxes; catch is that they generally pay lower yields
        ii. if purchase at par value and hold it until maturity, no capital gain
        iii. if sell before maturity and you generate a profit, capital gain
    e. mutual funds:
        i. "made up of a pool of funds collected from many investors, to invest in securities like stocks, bonds, money market instruments, and similar assets"
        ii. many similarities, except: when an internal capital gain occurs, it goes to money manager and money manager can distribute money when he/ she wants. Thus, invest if money manager is about to make a capital gains distribution.
    f. IRA - individual retirement account
        i. tax-free

<u>Argument Points</u>

48. GOP: Grand Old Party
    a. The Republican Party
49. Tea Parties: American political movement known for its conservative positions and its role in the Republican Party. Members of the movement have called for a reduction of the U.S. national debt and federal budget deficit by reducing government spending, and for lower taxes.
50. Republicans say their line in the sand is "no tax increases."
51. Republicans are talking tough about the problem being overspending, not under-taxation
52. 56% oppose raising taxes on earnings over $250,000 (Republicans)
53. 80% of Tea Partiers oppose raising taxes on Americans making more than $250,000 a year, a number that far exceeds the 56% of non- Tea Party Republicans who are opposed to such levies.
54. Cut taxes to stimulate economy and help families (Republican argument)
55. Budget surpluses are the result of over-taxation of the American people
56. Over taxation threatens to slow, and perhaps to reverse, the economic expansion
57. Low interest rates open up more housing opportunities than any government program.
58. Affordable housing is in the national interest. That is why tax reform should continue to encourage homeownership.
59. Older people with some accumulated equity can find an economic downturn very menacing because governments at all levels spend more on programs to help working-age families.
60. Marginal Tax Rates: the amount you pay on each taxable dollar earned above the deductible base.
    a. Decreasing the marginal rates would decrease the amount everyone pays, but in general would favor those who pay more tax

b. The current marginal tax rates are 15% on the first $42,350 of taxable income, 28% on the next $60,000, and 31%, 36%, & 39.6% above that
c. Those are the 'Married Filing Jointly' rates. The same marginal rates apply to singles, but at different breakpoints

61. Marriage Penalty: two people filing taxes together pay more than if they filed as two singles separately.
    a. This situation has existed in the tax code since 1969, when the tax code was reformed to account for women entering the workplace. The bill referenced above became law in June 2001 as the "Marriage Penalty and Family Tax Relief Act." It changed tax deductions and child credits to remove that aspect of the 'Marriage Penalty,' but did not address the core distinction that a couple filing jointly still pay more than the same couple filing separately.
62. Estate Tax' or 'Inheritance Tax' is called the 'Death Tax'- by its opponents, beginning in 2001 under President Bush. While polls indicate broad support for eliminating the estate tax, few Americans are directly affected by it. Opponents point out that some family businesses would have to sold to pay the estate tax.
    a. In 2001, 98% of descendants avoid taxes altogether because the first $675,000 of an estate was exempt from taxation. That exemption rose to $5 million in 2011-2012, with a one-year repeal in 2010, and is slated to return to $1 million in 2013.
    b. According to the Internal Revenue Service, about 3,000 estates are worth more than $5 million each and hence would be subject to the tax in 2011-2012.
63. Capital Gains Tax- a separate income tax (with a marginal rate of 20%) which applies when goods that have gone up in value are sold.
    a. Lowering the capital gains rate is considered a benefit to wealthier taxpayers.
64. 'Flat Tax' or <u>'Fair Tax'</u>- would replace the current progressive marginal rates with a single 'flat' rate (plans vary from 10% to 17%), applied after a deductible base.
65. Flat Tax plans can achieve lower rates by removing the mortgage interest and charitable deductions.
66. Flat Tax plans can achieve lower rates by removing the mortgage interest and charitable deductions.
67. Amendment XVI to the US Constitution
68. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration. (1913)

69.	DEMOCRAT	REPUBLICAN
70. Stance on Taxes	71. Progressive (high income earners should be taxed at a higher rate). Generally not opposed to raising taxes to fund government.	72. Tend to favor a "flat tax" (same tax rate regardless of income). Generally opposed to raising taxes.

73. Almost everything you own and use for personal purposes, pleasure or investment is a capital asset.

74. When you sell a capital asset, the difference between the amount you sell it for and your basis – which is usually what you paid for it – is a capital gain or a capital loss.
75. You must report all capital gains.
76. You may deduct capital losses only on investment property, not on property held for personal use.
77. Capital gains and losses are classified as long-term or short-term, depending on how long you hold the property before you sell it. If you hold it more than one year, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term.
78. If you have long-term gains in excess of your long-term losses, you have a net capital gain to the extent your net long-term capital gain is more than your net short-term capital loss, if any.
79. The tax rates that apply to net capital gain are generally lower than the tax rates that apply to other income. For 2010, the maximum capital gains rate for most people is 15%. For lower-income individuals, the rate may be 0% on some or all of the net capital gain. Special types of net capital gain can be taxed at 25% or 28%.
80. If your capital losses exceed your capital gains, the excess can be deducted on your tax return and used to reduce other income, such as wages, up to an annual limit of $3,000, or $1,500 if you are married filing separately.
81. If your total net capital loss is more than the yearly limit on capital loss deductions, you can carry over the unused part to the next year and treat it as if you incurred it in that next year.
82. Capital gains and losses are reported on Schedule D, Capital Gains and Losses, and then transferred to line 13 of Form 1040.
83. Capital gains aren't just for rich people
84. In most cases, your home is exempt
85. Length of ownership matters
86. If you sell an asset after owning it for more than a year, any gain you have is a "long-term" capital gain. If you sell an asset you've owned for a year or less, though, it's a "short-term" capital gain. And the tax bite from short-term gains is significantly larger than that from long-term gains.
87. Capital losses can offset capital gains
88. Business income isn't a capital gain
89. Capital losses may be used to offset capital gains and up to $3,000 of other taxable income. The unused portion of a capital loss may be carried over to future years.
90. Similarly, a capital loss occurs when an asset is sold for less than its basis.
91. A capital gain occurs when a capital asset is sold or exchanged at a price higher than its basis
92. Gains and losses are all measured in nominal terms-that is, unadjusted for inflation.
93. January 2015: President Obama proposed tax changes designed to raise some $320 billion over 10 years
94. The revenue would be used to cover $235 billion in tax breaks, mostly for moderate-income workers, along with other initiatives.
95. Obama also proposed: boosting the capital-gains rate to 28% for the top 1% of taxpayers, before it was 23.8%

96. Capital gain tax on many inheritance
97. GOP disagrees with Obama
98. The Yes Verdict: The system would punish those who put their money to work
99. taxes on investment earnings effectively double-tax that income,
100. Labor income is taxed when it is earned, The system affects the entire economy not just people who work
101. Investment capital= important drivers to economic growth“: If we want more inventions, or a faster cure for cancer, then we should have lower capital-gains taxes.”
102. Are capital gains so different from earned income that they should be taxed at a different rate? The Bowles-Simpson proposal recommends taxing capital gains and dividends at the same rate as labor income
103. Democrats: raising the rate, citing concerns about both revenue and inequality
104. “The justification for a lower tax rate on capital gains relative to ordinary income is threefold”: it is not indexed for inflation, it is a double tax ,it encourages present consumption over future consumption.

Sources

2015 Greater Green Bay Fact Book. (n.d.). Retrieved February 15, 2016, from http://www.titletown.org/media/374307/factbook15_email.pdf

5 Things You Should Know About Capital Gains Tax. (n.d.). Retrieved February 3, 2016, from https://turbotax.intuit.com/tax-tools/tax-tips/Investments-and-Taxes/5-Things-You-Shoul -Know-About-Capital-Gains-Tax/INF26154.html

Fields, M. (2016). Understanding risk. Retrieved February 8, 2016, from http://www.ameripriseadvisors.com/michael.c.fields/articles/9/understanding-risk/

How an investment is taxed. (n.d.). Retrieved February 7, 2016, fromhttps://www.ameriprise.com/research-market-insights/tax-center/tax-planning/how- are-ivestments-taxed/

Investopiedia - Educating the world about finance. (n.d.). Retrieved February 02, 2016, from http://www.investopiedia.com/

Is It Fair to Tax Capital Gains at Lower Rates Than Earned Income? (n.d.). Retrieved February 1, 2016, from http://www.wsj.com/articles/how-should-capital-gains-be-taxed-1425271052

Republican Party on Tax Reform. (n.d.). Retrieved February 1, 2016, from http://www.ontheissues.org/Celeb/Republican_Party_Tax_Reform.htm

Ten Important Facts About Capital Gains and Losses. (2011, February 18). Retrieved February 3, 2016, from https://www.irs.gov/uac/Ten-Important-Facts-About-Capital-Gains-and-Losses

Tsiko, S. (2014, November 18). BH24 » Biotech can drive economic growth. Retrieved February 11, 2016, from http://www.bh24.co.zw/biotech-can-drive-economic-growth/

Vorpagel, T. (2016, January 30). Capital Gains [Personal Interview].

What drives economic development. (n.d.). Retrieved February 6, 2016, from http://www.growthandjustice.org/facts.fixes/economic/drives