Committee On Finance

Max Baucus, Ranking Member

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Additional Remarks Regarding Capital Gains and Dividends Tax Cuts
Senate Floor Statement of U.S. Senator Max Baucus (D-Mont.)

Mr. President, the capital gains and dividends tax cuts contained in the House bill are among the matters most in dispute in this legislation. Let me take a few moments to discuss why Congress does not need to extend them in this bill.

Under current law, taxpayers who earn money in capital gains and dividend income pay taxes on that income at a lower rate than they do on their ordinary income, like wages. The 2003 tax law set the current law for the taxation of capital gains and dividend income.

For taxpayers in most income brackets, capital gains and dividend income are taxed at 15 percent. Taxpayers in the lower two tax brackets do not receive a great deal of capital gains and dividend income. But for taxpayers in those two brackets, what capital gains and dividend income they receive is taxed at five percent now, and will be tax-free in 2008.

Prior law taxed long-term capital gains at 20 percent or 10 percent. And prior law taxed dividend income just like any other ordinary income.

The House bill would extend the lower tax rates that Congress enacted in 2003 through the end of 2010.

The first question before us today is: When does Congress need to act on capital gains and dividend income tax rates?

Those rates do not expire this year. Those rates do not expire next year. Those rates do not expire the year after that. Those rates expire on January 1, 2009, nearly three years from now. So the first thing we need to note today is that extension of capital gains and dividends tax rates is far from an urgent matter.

The second question we need to ask is: Is it fiscally responsible to extend those tax cuts right now?

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According to the Joint Committee on Taxation, the cost of a two-year extension of those tax rates amounts to $50 billion over a ten-year budgetary horizon. Now some who like lower capital gains and dividends tax rates will cite a lower <u>five-year</u> cost of $20 billion. But that masks the full cost over the decade to come.

And perhaps we should be even a little more frank with the American people. Because it is no secret that many who like lower capital gains and dividends tax rates would like to make those lower rates permanent. That is the position that the administration takes. So we ought to look at the cost of making those rates permanent. According to the President's new budget request, making these tax cuts permanent would cost more than $200 billion over ten years.

$200 billion is a lot of money. $200 billion is about what we spend on fighting crime, combating drugs, and the entire administration of justice for five years. $200 billion is about what the Federal Government spends on highways, airports, and the entire transportation budget for three years. And $200 billion is about what we spend on veterans' retirement and disability benefits for six years. So extending capital gains and dividends tax cuts costs real money.

The third question we need to ask is: Are capital gains and dividends tax cuts the best use of the money set aside for tax cuts in the budget. For there is a far more pressing need for tax relief right before us in this bill: And that is relief from the onerous alternative minimum tax.

Millions of working families are beginning the annual ritual of filing out their tax returns. It takes more time than most would like. And millions of taxpayers are being forced to fill out their returns twice. They have to do so to see if they owe money under the alternative minimum tax.

And the need for relief from the alternative minimum tax is not some far-away possibility several years down the road. Relief from the alternative minimum tax expired for tax year 2006. That is the more pressing tax relief need before us today.

Treasury Secretary Snow testified before the Senate Finance Committee last Tuesday. He told the Committee: "Tax increases carry an enormous risk of economic damage. And I can tell you today that the President will not accept that risk. He will not accept a tax increase on the American people."

That is exactly why we need to prevent a tax increase on those working American families who would become subject to the alternative minimum tax, unless we act.

Similarly, the popular research and development tax credit expired this year. Businesses have argued for years that the annual, one-year extension provides no certainty for business planning and investment. We need to extend the R & D tax credit.

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Now some will make breathless arguments that capital gains and dividends tax cuts are necessary to prevent dire consequences in the stock market. But let's look at the evidence.

Let's look at the time period starting in May 2003, when Congress reduced the dividend and capital gains tax rates. Since then, the stock market has seen 14 percent growth.

Furthermore, let's look at the time when the Congress first cut the capital gains tax rate, in August 1997. Between then and the time the further cuts were made in May 2003, the market grew by 13 percent.

Now, let's look at the time before either the capital gains or dividends tax cuts. Before the 1997 tax cuts, capital gains were taxed at 28 percent. And dividends were taxed as ordinary income. In those times of higher capital gains and dividends tax rates, between the time the Clinton Administration took office and August 1997, the market grew by 236 percent.

So the evidence is just not there that lower capital gains and dividends tax cuts will lead to increased stock prices. Indeed, one could readily make the case that other economic factors are much more important to stock market returns than capital gains and dividends tax rates are.

One of those factors was the fiscal responsibility of the mid-1990s. After President Clinton took office in 1993, Congress and the President enacted meaningful deficit reduction. We reduced the Government's demand for scarce capital. We freed up savings to finance productive business investments. And we put the Nation on a path to economic growth.

In contrast, financing tax cuts by running greater deficits increases the Government's demand for scarce capital. Deficit-financed tax cuts take away savings that could be available to finance productive business investments. Increasing the deficit detracts from economic growth.

To encourage economic growth, we need to get deficits under control. And the first step that we can take down that road is to stop making the deficit worse by enacting more tax cuts than we can afford.

Capital gains and dividends tax cuts do not expire for three years. Capital gains and dividends tax cuts cost a lot of money. Capital gains and dividends tax cuts are a less pressing priority than relief from the alternative minimum tax. And the evidence is simply not there that capital gains and dividends tax cuts contribute to market strength.

So that is why we do not need to extend capital gains and dividends tax cuts today. Rather, let us address the more pressing need to extend relief from the alternative minimum tax. Let us act responsibly. And let us save capital gains and dividends tax cuts for another day.

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