



# AMERICANS *for* TAX REFORM

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President

## AMERICA'S GROWTH AGENDA

### *Part Three: Allow Investors to Index the Basis of Their Capital Gains to Inflation*

Proposal: Capital assets sold in 2008 would have their bases adjusted for inflation

#### Current Law

Since the origins of the income tax in 1916, Congress has nearly always allowed a special treatment for capital gains income. "Capital gains" is nothing more than profit a taxpayer receives from the sale of an asset.

The reason for this special treatment is twofold: first, many capital assets are corporate stocks—stocks of companies that have already paid the corporate income tax. Second, and more important for these purposes, is that there has never been a way to properly account for the effects of inflation on this "profits tax."

#### Example

Joe buys a share of XYZ stock for \$100. Ten years later, the stock is worth \$125. He sells the stock, and reports a \$25 capital gain.

Meanwhile, inflation has occurred. Joe would have to spend \$130 today to get the same value as \$100 back when he bought the stock. **So even though he lost \$5 after inflation, Joe still has to pay taxes on his \$25 "profit."**

#### Pro-Growth Solution

Allow Joe to increase his basis in XYZ stock by the rate of inflation. When he sells the stock, he would actually report a \$5 loss. This reflects the actual economic reality for Joe, who is otherwise being taxed purely on inflationary gains.

A very good economic growth idea would be to allow all assets sold in 2008 to have their bases adjusted for the effects of inflation over the years. **Some have calculated that this would be the equivalent to a cut in the capital gains tax rate of 50%.**

There is some evidence that the Treasury Department could do this unilaterally, so a dual-track approach (Congressional Republicans and the Administration) would be an ideal scenario.

**Fun Fact:** This bill was actually introduced by Congressman David Dreier as H.R. 44 in the 108<sup>th</sup> Congress.

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