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Spending Law Adds New Ways to Reduce Capital-Gains Tax

BY RICHARD RUBIN

WASHINGTON— Congress expanded opportunities for taxpayers to postpone, minimize or avoid capital-gains taxes in President Trump's new tax law, giving boosts to investors without cutting the headline rate.

While Trump-era Republicans have cut taxes on wages, business income, corporations and estates, they have left the top capital-gains rate exactly where it sat on Jan. 1, 2013: 23.8%. But behind that stasis, Congress continued shrinking the capital-gains tax base.

In the tax-and-spending legislation that Trump signed into law July 4, Republicans reupped the Opportunity Zone tax break for investments in low-income areas and made it permanent, letting investors defer and reduce taxes.

They also expanded a break often used by venture-capital investors that can wipe out capital-gains taxes when a startup is sold.

"What you see there is targeted tax relief," said Dave Kautter, the Treasury Department's top tax-policy official during the first Trump administration. "You see Congress and the administration identifying initiatives where they think change can make a significant difference compared to a broad across-theboard cut."

Republicans nearly included a capital- gains tax break in their new schoolchoice tax credit but changed course at the last minute. Still, the new law's estatetax cut and blessing for business paths around the cap on the state and local tax deduction indirectly lighten the tax load on capital gains. So do enhanced health savings accounts and corporate tax cuts, including the 2017 taxrate reduction and this year's expanded investment deductions.

"All of this is expanding

choice for sophisticated taxpayers in order to get the best deal they can out of the tax system, and in ways that don't make a lot of sense," said David Kamin, a senior tax-policy official in the Obama and Biden administrations.

Capital-gains taxes—the levy on investment profits— are among the U.S. taxes with the most concentrated effects on the highest earners. People earning $10 million or more reported receiving 39% of long-term capital gains in 2022, according to Internal Revenue Service data.

Maximum revenue

Collections of the tax are particularly sensitive to rates, and the current 23.8% level may be close to revenue-maximizing. When Congress raises rates, people tend to hold appreciated assets instead of selling. When Congress lowers rates, people sell to lock in lower-taxed gains.

Republicans tried for decades to drive down capitalgains tax rates, arguing that it was an important way to spur investment and risk-taking. They succeeded, reducing the top rate to 20% from 28% in a deal with then-President Bill Clinton, a Democrat, and then to 15% under President George W. Bush, a Republican.

The top rate jumped to 23.8% in 2013 because a new 3.8% investment tax from the 2010 Affordable Care Act took effect and because a bipartisan agreement returned the basic top rate to 20%. The new changes leave those rates alone while carving out more breaks. Beyond the new law, there are periodic attempts by conservatives to get the Treasury Department to take the legally questionable move of adjusting capital gains for inflation.

"Republicans are utilizing these other policies to provide exclusions or exemptions, and maybe politically, that relieves some of the pressure on the rate," said Daniel Bunn, president and CEO of the Tax Foundation, which favors a simpler tax system with lower rates and fewer breaks.

Opportunity calling

Opportunity Zones, which have bipartisan roots, help investors reduce capital-gains taxes. Investors roll gains into a special fund to defer taxes. They get a 10% tax reduction if they hold the Opportunity Zone investment for five years—and triple that for rural investments under a new provision. The Opportunity Zone investment itself can be free of capital-gains taxes after 10 years.

"Somebody who's planning an exit, selling a family business, it's a good opportunity to shelter your gains, and they've made it even more enticing," said Dan Ryan, a tax attorney at Sullivan & Worcester in Boston.

The Opportunity Zone changes are projected to save taxpayers $41 billion through 2034.

The other major new change expands the break for qualified small-business stock under tax code Section 1202. That provision has enjoyed bipartisan support and backing from the venture-capital and high-tech industries, and it is used to entice investors in startups with growth potential. The break can let investors eliminate all capitalgains taxes when they sell stock that meets specified criteria. The new law enhances several features and is projected to save taxpayers $17 billion.

The break is now capped at $15 million or 10 times the original investment, whichever is greater. That $15 million was increased from $10 million. Slightly larger businesses can now qualify, and investors can get a partial tax break if they hold stock for three years instead of waiting for five.

Howard Wagner, a managing director at accounting firm Forvis Mazars, called Section 1202 "about as powerful an incentive as you can get," and said that the new law gives investors more flexibility.

Congress also expanded the estate-tax exemption to $15 million per person, tied that figure to inflation and removed the expiration date that threatened to cut the exemption roughly in half.

The changes mean more than 99.8% of people dying annually will avoid the estate tax. It is now easier for almost everyone to hold taxable assets and take advantage of the law that wipes out capital-gains taxes on appreciated assets at death. Heirs pay only on subsequent capital gains, and only if they sell assets.

"If you can hold it, even though a 23.8% rate is pretty good, zero is better," said Kautter, now at accounting firm RSM.

The Biden administration tried and failed to raise capital- gains rates and change the tax treatment of gains at death.

"We increasingly have income that simply never gets taxed, and it won't get taxed either through the capitalgains tax system or the estate tax," said Kamin, now a New York University law professor.

Some people will adjust prior plans because of the estate- tax change, said Joshua Landsman, a senior wealth strategist at Wilmington Trust. They could swap investments so that assets with a lot of unrealized capital gains move to personal accounts and get the tax- free treatment of gains at death while other assets go into trusts.

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