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Obama tax reforms are misguided

By Constantine Katsoris, chairman of the Securities Industry Conference on Arbitration and the Wilkinson Professor at Fordham Law School

When talking about special taxation for capital gains, we are assuming that a certain holding period is satisfied and that it is truly a capital gain to begin with – not earned income (from blood sweat and tears i.e. fees or wages) masquerading as capital gains. True capital gains represent gains to someone who places their capital at risk – an investment upon which taxes have already been subject to the income tax (when earned) and/or gift or death taxes (when transmitted). The risk of loss is particularly significant when examined in the light of the tax treatment, which limits net capital losses to $3,000 per year. For example, if an investor had capital gains on a stock transaction of one million dollars in one year he would pay a tax on that gain; yet, if he took that money and made a new investment on which he lost one million dollars the next year, it would take him 333 plus years (at a $3,000 rate) to take that loss. This is a scenario that proponents of taxing capital gains as ordinary income conveniently ignore. If, in fact, capital gains are ordinary income, capital losses should be as well. If that were the case, just imagine the effect on the US Treasury's revenue in recessionary years where large capital losses would occur. Moreover, when capital gains are recognized it is often discretionary, and raising the rates either directly or indirectly will often delay their recognition, causing a "lock-in" effect on capital investment.

Reducing deductions for "High Earners" creates geographical warfare, for there is a world of difference between someone earning $200,000/250,000 in rural America and someone earning that amount in New York City who has to contend with significant State and City income taxes, high rents/and or property taxes and possibly has student loans to repay or college tuitions for his or her children. Under such circumstances, elimination of many of the aforementioned deductions would not only be unjustifiable (because the "High Earners" are not really "fat cats") but unwise. Eliminating home deductions (interest and realty taxes) would exacerbate an already fragile real estate market, and eliminating the charitable deduction would result in a reduction of charitable contributions to agencies that are more often effective at serving social needs than the government. Therefore, we should reject these piecemeal tax changes such as the "Buffet Rule" and the elimination of deductions for so called "High Earners." They are offered as long-term, stand – alone solutions accompanied with inaccurate and unfair sound bites intended to gain political favor in the short term. What this country needs is a systematic overall examination of the tax code that looks at unnecessary loopholes and encourages long term economic growth in an ever increasingly competitive world economy.

Constantine Katsoris is chairman of the Securities Industry Conference on Arbitration and the Wilkinson Professor at Fordham Law School specializing in tax law and securities law.

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