Investing in the Future
Revenue Options to Give Every Child the Opportunity to Learn

Capital gains are profits derived from the sale of assets like stocks, bonds and real estate. Unlike wage and salary income, capital gains overwhelmingly benefit higher-income households. The top 1 percent of U.S. households receive over 70 percent of all capital gains income while the bottom two-thirds of households receive just six percent.

Because they are separate from wage and salary income, capital gains can be taxed differently, though most states don’t differentiate between the two, taxing them at the same rates. Instead, if states taxed what is often called “unearned income” (capital gains and other non-wage and salary income) at higher rates, they would raise new revenue and make state tax systems more fair. In eight states (Arkansas, Hawaii, Montana, New Mexico, North Dakota, South Carolina, Vermont, and Wisconsin) capital gains income even enjoys preferential treatment in the tax code, lowering taxes on this type of income. Equalizing the tax treatment of earned and unearned income in these states would be a progressive way to produce tens of millions to hundreds of millions in new revenue annually.

WAYS TO DO IT

EQUALIZE TAX RATES FOR CAPITAL GAINS AND EARNED INCOME
For states that tax long-term capital gains at lower rates than earned income, simply leveling the playing field by applying identical rates would produce additional revenue for the state in a highly progressive manner. For example, in Hawaii, instituting this change would generate between $30 million and $40 million annually, with over 90 percent of the new revenue coming from the top 1 percent of filers.

ELIMINATE CAPITAL GAINS TAX BREAKS
A number of states give tax breaks to capital gains income. Eliminating these special tax breaks — and thereby leveling the tax playing field between capital gains and earned income — can raise substantial revenue and improve the fairness of a state’s tax system.

RAISE TAXES ON CAPITAL GAINS INCOME ABOVE RATES APPLIED TO EARNED INCOME
In states that currently treat capital gains and earned income (wage and salary income) identically for tax purposes, it may be possible to reform the tax code such that higher tax rates are applied to capital gains than to earned income. One possibility is to raise existing rates on capital gains above the rates applied to earned income. Another option is to establish a special tax applied only to capital gains.

DOWNLOAD THE FULL TOOLKIT: www.otlcampaign.org/reports/raising-revenue
Investing in the Future
Revenue Options to Give Every Child the Opportunity to Learn

TALKING POINTS: STATE REVENUE STRATEGIES

Taxes are the way we pay for the many important things we do together through our governments. The common goal of the tax reform proposals presented on the Investing in the Future website is to generate revenue sufficient to pay for schools and universities, roads and bridges, subways and buses, police and fire departments, libraries and parks, and so much more.

Any proposal to generate new tax revenue, however, necessarily raises a number of important questions: How will these tax changes affect the state’s economy? How will the changes affect family budgets? How can proponents facilitate a thoughtful and constructive public discussion of the proposals at hand? Below is an overview of responses to each of these questions – greater detail can be found on the Background Basics page of the Investing in the Future website.

TAXES & THE ECONOMY

The evidence strongly indicates that when appropriate investments are paid for with well-structured tax increases they result in significant positive net impacts to a state’s economy, particularly over the long term.

- Raising taxes on high-income households = substantial net tax revenue gains
- Raising taxes on high-income households does not lead to substantial migration out-of-state
- States with higher tax levels do NOT have weaker economies than low-tax states
- Better educated workforce = higher wage economy

FAIRNESS

In every state in the U.S., low and middle-income households pay more of their income in combined state-and-local taxes than high-income households do. It is reasonable, therefore, that efforts to raise more revenue for education and other public investments would seek to collect that new revenue from high-income households. This would bring the tax levels of high-income households closer to the levels paid by other households.

The goal of tax reform is to generate adequate revenue to pay for essential government functions, and to raise that revenue in a fair way.

TALKING ABOUT TAXES AND GOVERNMENT

Thirty years of determined anti-tax/anti-government messaging has undermined the general public’s belief in the essential, positive role that government plays in our daily lives. The fact is, we do many great things – large and small – for our communities, working together through our federal, state and local governments. Telling this positive story is essential, just as it is essential to offer a positive, aspirational vision of the future:

- Help people imagine how their communities can benefit from increased investment in schools, roads, libraries, public safety and more.
- Remind people of the direct connection between these public goods and the taxes we all pay.
- Focus discussion on overall public benefit and revenue gains of a particular tax proposal rather than an extensive debate on the minor details of a given plan.
- Remember to stay positive and inclusive and to focus on the big picture: Tax reform is a tool that will help people realize the aspirational visions they have for their communities.

DOWNLOAD THE FULL TOOLKIT: www.otlcampaign.org/reports/raising-revenue