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## United States Senate

September 13, 2019

The Honorable Steven T. Mnuchin  
Secretary of the Treasury  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Dear Secretary Mnuchin:

I write in support of President Trump's recent decision not to direct the Department of the Treasury to amend capital gains tax law using executive authority. Not only would such a change stand on dubious constitutional and legal ground, but it would primarily benefit wealthy investors without supporting American workers.

I believe any consequential change in law should be enacted in a constitutional manner. If in the future the administration again considers whether to support eliminating inflationary gains when calculating capital gains liability, I would urge the Administration to begin the process by seeking congressional approval.

Indexing the cost basis for capital gains to inflation would mark a dramatic change in tax policy. Since Congress first established a separate tax rate for capital gains in 1921, it has never indexed the tax to inflation, despite considering the issue in numerous tax debates. Less than two years ago, Congress passed the *Tax Cuts and Jobs Act of 2017*, which included new capital gains tax brackets tied to inflation, but did not tie the cost basis to inflation.

Making this change unilaterally could create the potential for further arbitrage in our tax code. For instance, an investor could buy an asset for \$100 that is fully financed by a loan. If the inflation rate and the nominal interest rate on the loan were both 3%, the asset would be worth \$103 a year later on account of inflation. If the cost basis were indexed for inflation, the investor could sell the asset for \$103 and pay no capital gains tax. However, the investor could subsequently claim an interest deduction of \$3 with no offsetting gain, despite the fact that the investor is in the same pre-tax position. Pursuing this change in isolation limits Treasury's ability to ensure investors do not generate large paper losses which only lead to greater inefficiencies.

While some choose to interpret recent fluctuations in the stock market to be a sign of potential economic weakness, the real economy remains strong. America is experiencing low unemployment, rising wages, and strong GDP growth in its longest economic expansion in history. Enacting a stimulus for financial markets signals uncertainty instead of supporting the strong fundamentals behind our economy.

Furthermore, reducing the "lock-in" effect, or the incentive for investors to keep holding stock for tax purposes, may be counterproductive during an economic downturn. U.S. stock markets today reduce more equity than they issue.<sup>1</sup> Encouraging investors to sell their stocks through inflation indexing could risk a sell-off. Additionally, investors are not starved for capital, but rather productive investments are

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<sup>1</sup> <https://www.nber.org/reporter/2018number2/stulz.html>

increasingly difficult to find.<sup>2</sup> This retroactive tax cut creates a windfall for those who have already invested in capital assets based on past decisions, rather than encouraging future capital formation.<sup>3</sup>

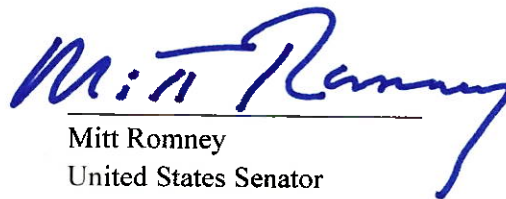
I also welcome President Trump's focus on the welfare of American workers, and share his notice that the proposed change would accrue primarily to high-income Americans.<sup>4</sup> In 2018, 91.4% of Americans reported no long-term positive gains, while the top 1% of income earners paid 72.0% of all capital gains tax.<sup>5</sup> The average tax paid on gains for taxpayers in the middle quintile is \$280 – far less than the top 1% that pays \$157,890 on average.<sup>6</sup> Furthermore, all contributions and earnings taxpayers withdraw from traditional retirement accounts, such as a 401(k) or an IRA, are taxable as ordinary income and do not stand to directly benefit from indexing capital gains.

With a record \$22 trillion national debt, a regulatory tax cut with no offsetting spending cuts could significantly increase the debt. The Tax Foundation estimates this change would reduce federal revenue by \$178 billion over the next decade.<sup>7</sup> Future tax cuts should be made in tandem with responsibly reducing federal spending.

Finally, I note that in 1992 the Office of Legal Counsel concluded that the Treasury Department does not have the legal authority to take this regulatory action, and noted that it would likely be challenged in court.<sup>8</sup> At a minimum, doing so would raise significant legal questions. Regardless of the merits of this policy change, it would be counterproductive to proceed in a way that creates uncertainty for American families and businesses while those issues are resolved.

The merits of indexing capital gains to inflation deserve careful consideration by Congress. I strongly urge you to consider these concerns in any future discussions on this matter.

Sincerely,



Mitt Romney  
United States Senator

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<sup>2</sup> <https://www.imf.org/en/Publications/WP/Issues/2018/12/07/The-Rise-in-Corporate-Saving-and-Cash-Holding-in-Advanced-Economies-Aggregate-and-Firm-Level-46369>

<sup>3</sup> <http://valexreg.com/articlepdfs/36-JREG-693-Hemel.pdf>

<sup>4</sup> <https://www.bloomberg.com/news/articles/2019-08-21/trump-says-he-isn-t-immediately-planning-capital-gains-tax-break>

<sup>5</sup> <https://www.taxpolicycenter.org/model-estimates/distribution-individual-income-tax-long-term-capital-gains-and-qualified-28>

<sup>6</sup> *Id.*

<sup>7</sup> <https://taxfoundation.org/economic-budget-impact-indexing-capital-gains-inflation/>

<sup>8</sup> <https://www.justice.gov/file/20536/download>