August 10, 2001

Mr. John Angell	Mr. Kolan Davis
Majority Staff Director	Republican Staff Director/Chief Counsel
Senate Finance Committee	Senate Finance Committee
United States Senate	United States Senate
219 Dirksen Office Building	219 Dirksen Office Building
Washington, DC 20510	Washington, DC 20510

Re: Tax Code Complexity Hearing

Dear Messrs. Angell and Davis:

This letter is sent in response to a request from Senator Grassley that I submit additional information discussing my recommendations for reducing complexity in calculating taxes on capital gain income.

The capital gain regime applicable to individuals is excessively complex. Seventeen different rates of tax may apply to capital gain income.[1] Individuals with net capital gain compute their tax liability by completing a 36-line tax computation on Schedule D of Form 1040. For taxable years beginning after 2000, additional lines will be needed to take into account five-year gains.

In our testimony, we noted that the taxation of capital gain would be simplified by establishing a single preferential rate and a single long-term holding period for all types of capital assets. Alternatively, in order to assure that the benefit is extended to all taxpayers regardless of their tax bracket, the special capital gain rate might be replaced by an exclusion for a specified percentage of long-term capital gain.

The Joint Committee on Taxation recommended in its simplification study that the current rate system for capital gain be replaced with a deduction for a fixed percentage of net capital gain.[2] The recommendation would reinstate a deduction

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[1] Joint Committee on Taxation, Study of the Overall State of the Federal Tax System and Recommendations for Simplification, pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986, JCS-3-01, Volume II, p. 102, April 2001.

[2] Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. I.R.C. § 1211(b).

similar to the capital gain deduction in effect prior to the Tax Reform Act of 1986, and is substantively equivalent to the exclusion we recommended in our testimony.[3]

The enactment of any of these recommendations would be a significant step in reducing complexity for individual taxpayers.

Very truly yours,

Richard M. Lipton
Chair, Section of Taxation

cc: Senator Charles Grassley

[3] Joint Committee on Taxation, Study of the Overall State of the Federal Tax System and Recommendations for Simplification, pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986, JCS-3-01, Volume II, p. 106, April 2001. The recommendation would not change the exclusions for small business stock, D.C. Enterprise Zone stock, or Renewal Community stock.