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# A quick way Trump can help small business

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Small businesses gearing up to pay their first-quarter taxes on April 17 are in for a welcome surprise. Lower tax rates and a new 20 percent small business tax deduction, the result of recently passed tax cuts, will allow significant tax savings beginning this tax period.

While these tax cuts provide long overdue relief for American small businesses, they didn't address one of the biggest taxes affecting small businesses: the capital gains tax.

The capital gains tax, which currently stands at 23.8 percent, hits small businesses like hotel franchisees especially hard. It disincentives business creation, dampens access to capital, and punishes business growth. It also exacts a painful toll on businesses' appreciating assets, including real estate.

In today's political environment, the prospects of passing legislation to lower the capital gains tax rate are slim. But President Trump can effectively lower the capital gains rate through an executive order that directs the Treasury Department to adjust capital gains tax for inflation. This reform would bring significant tax relief to small businesses and generate a massive economic stimulus.

The capital gains tax is an outlier, unlike nearly all other taxes, in that it does not adjust for inflation. Income thresholds for individual income tax rates, for instance, all rise each year along with inflation. As a result, capital gains tax is partially levied on phantom and not real gains in the value of an asset. Consider, for example, a hotel franchisee who purchases a location in 2000 for $2 million and sells it in 2018 for $6 million. He makes a nominal $4 million profit, all of which is subject to a 23.8 percent tax. But part of this capital gain — in this case roughly $1 million — is a result of inflation, not a growing asset value.

According to the Bureau of Labor Statistics inflation calculator, the $2 million purchase price is worth about $3 million in today's money. So the real capital gain should be $3 million — 25 less than under the current code. The tax paid would fall from $952,000 to $714,000.

According to a Tax Foundation analysis, the real capital gains tax — in terms of tax paid on actual capital gains (not inflation) — is 42.5 percent, nearly double the stated 23.8 percent. Treasury can fix this quirk in the tax code by issuing a rule stating that capital gains tax is subject to real — not nominal — capital appreciation.

According to former Treasury economist Gary Robbins, roughly one-fourth of annual capital gains tax is paid on inflation. In other words, fixing the tax would be the equivalent of a 25 percent capital gains tax cut.

This change would have a massive effect on the economy. It would incentivize business creation, investment, and productivity increases, while leaving billions more dollars in the private economy. Robbins estimates it would grow U.S. capital stock by $1.1 trillion, boost GDP by roughly $500 billion, and create 400,000 jobs. It would also help boost retirement plans and reduce the tax burdens of realizing them.

Trump has two major supporters of this reform very close to him. Larry Kudlow, Trump's new top economic advisor, is a leading champion. And Vice President Mike Pence introduced legislation in 2006 when he was a congressman to adjust capital gains for appreciation for assets held for at least three years.

Opponents claim that such a capital gains tax cut would reduce revenue. That's far from certain. Such a tax cut would spur countless entrepreneurs to realize their capital gains, potentially creating billions of dollars in immediate new revenue. Lower rates have historically resulted in a greater number of transactions, as owners are more willing to sell assets when tax rates are low. The resulting economic growth would also mean there are bigger capital gains to tax.

Like its recent legislative counterpart, this executive branch tax cut would strengthen the small business backbone of the economy. It would be the feather in the cap of the recent tax cuts.

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