1 May, 2021

Biden calls for historic tax hike on capital gains for the "Rich Man"

On Apr 28, Biden gave his first 100 days in office speech to congress and outlined domestic and foreign priorities, a proposal more than $4 trillion spending that he called a 'once-in-a-generation investment to restructure the American economy'.

Biden unveiled the $2.25 trillion **American Jobs Plan** in late March, which covers infrastructure and clean energy, would be financed through corporate tax hikes in order to boost labour force participation and strengthen the economy. In addition to that, Biden proposed the tax hike plan on capital gains for the wealthy aims to fund massive $1.8 trillion education and child care programme - **American Families Plan**, including two years of childcare, universal pre-kindergarten education and paid leave for workers.

Tax reform

Personal capital gains and income tax

Currently, the long-term capital gains (for the gain from assets held more than a year) tax rate divided into three categories which are 0%, 15% and 20% depending on taxable income and filing status. An asset owned for less than one year is considered as ordinary income and there are 7 tax brackets ranging from 10% to 37%.

Under the Biden's proposal, the long-term capital gains tax rate would be increased from 20% to 39.6%, with an effective rate of 43.4% when the Medicare surtax on investment returns is added, for people with incomes of more than $1 million. In addition, Biden also proposed to return the top income tax rate to 39.6%, from 37% under Donald Trump's tax cuts. As said by the US government, the increase on capital gains tax rate would impact only 0.3% of US households while increasing the highest individual income tax rate would impact only the top 1% of taxpayers.

Corporate tax

Biden also proposed raising the corporate tax rate to 28%, but Republicans have rejected the idea of raising taxes. They stated that they would rather Congress focus on infrastructure projects, like roads, bridges, airports and broadband access.

Raising in corporate tax strikes the heart of what makes the wealthiest Americans ever wealthier. According to Federal Reserve data, more than 50% of shares in companies and mutual funds are owned by the wealthiest 1% in the country. The next 9% of the richest own more than a third of equity positions. To sum up, the top 10% Americans hold more than 88% equities. The top 10 richest Americans own with more than $1 trillion, according to the Bloomberg Billionaires Index.

Will tax rate increase lead to any negative impact to the stock market performance?

The stock market tumbled after the rumors of possible tax hike on 22 Apr. The S&P 500 dropped 0.94%, the Dow Jones fell over 0.94% while NASDAQ was down 0.92%. But they quickly rebounded on 23 Apr by 1.1%, 0.7% and 1.4% respectively.

Refer to the below graph, it shows the correlation between the previous tax hikes and the stock market performance.

Higher Cap Gains Haven't Hurt Stocks Lately

S&P 500 Index Performance After Increases In Capital Gains Taxes

			S&P 500 Index Returns			
Date Of Higher Capital Gains	Old Rate	New Rate	Three Months Before	Next Three Months	Next Six Months	Next Twelve Months
1/1/2013	15.0%	23.8%	1.5%	6.7%	10.5%	25.3%
1/1/1987	20.0%	28.0%	5.4%	19.1%	24.0%	0.3%
10/4/1976	36.5%	39.9%	0.5%	1.6%	-5.6%	-7.7%
12/30/1969	27.5%	36.5%	-1.6%	-1.7%	-20.4%	-0.6%
Average			1.4%	6.4%	2.1%	4.3%
Median			1.0%	4.1%	2.4%	-0.2%
% Positive			75.0%	75.0%	50.0%	50.0%

Source: LPL Research, Ned Davis Research, FactSet 04/23/21

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Source: LPL Financial

There are no statistically significant findings shown that raising capital gains tax will lead to any negative impact to the stock market performance, at least few months before and after the tax hike. Besides, it also shown from UBS research team that the tax hike will not lead to any significant impact to the "valuation" as the "price-to-earnings multiples could be as low as 10x when the capital-gains tax rate was 20%, but could be as high as 18x when it was 35%". Ultimately, other factors such as the outlook for economic growth, monetary policy, and interest rates are much more powerful drivers on equity market returns and valuations.

Although the above studies showed that raising capital gains tax will not lead to any significant negative impact to the stock market performance, it does not mean that it will not have any impacts to the market. At least, it will lead to some uncertainties to the market. First of all, it is still uncertain what will ultimately pass the Congress. Besides, even it comes to final legislation, it is expected to be a months-long process. Some Democrats, not to mention most Republicans, are likely to oppose the proposed increase. In addition, it is possibly will trigger a short-term selloff in stock market right before the tax hike really implemented, as by realizing the capital gain before the tax rate hike, investors can avoid paying a higher tax burden. Indeed, recently, America's wealthiest are reportedly scrambling to move their assets around away with more than US$178 billion, reported by market watcher.

Apart from the impact to the stock market performance, the raising tax rate also raised a question of what is the tax rate level which will eventually provide a disincentive to people from investing and thus jeopardizes the long-term US economic prosperity.

Source: SCMP, the fiscal times, Bloomberg, Yahoo Finance, Reuters, MarketWatch,

For any comments, please send email to us at info@asset-mg.com.

Asset Management Group
Unit 02, 40/F, 118 Connaught Road West, Hong Kong
Telephone: (852) 3970 9595 Facsimile: (852) 3107 0932