Congressional Budget Office
Nonpartisan Analysis for the U.S. Congress

CBO’s Projections of Realized Capital Gains Subject to the Individual Income Tax

February 2023

Summary

- Newly available data indicate that capital gains realizations in 2021 were unusually large. Those gains help explain the recent strength in receipts from individual income taxes.

- In the near term, capital gains can be challenging to project because realizations tend to fluctuate more than other economic variables or revenue sources.

- In the longer term, the Congressional Budget Office expects capital gains realizations to approach their historical average relative to the size of the economy, after adjusting for differences between historical tax rates and those in the projection period.

- In CBO's February 2023 baseline projections, capital gains realizations decrease from an estimated high of 8.7 percent of gross domestic product (GDP) in 2021 to a long-run average of 3.7 percent of GDP by 2033.

What Are Capital Gains, and How Are They Taxed?

Capital Gains and Capital Gains Taxes

A capital gain is an increase in the value of a capital asset above what it cost its owner to acquire or improve it. Typical capital assets include financial market assets, such as stocks, mutual funds, and bonds; ownership in private businesses; real estate; and antiques, jewelry, and collectibles.

Taxes on capital gains are levied when the gains are realized—that is, when a taxpayer sells an asset. The tax is levied on the difference between the net sale price of the asset and its cost basis. The cost basis of the asset is typically adjusted upward for any improvement expenses and downward for any depreciation expenses that previously reduced the taxpayer’s taxable income.

A taxpayer who sells more than one asset in a year must aggregate any gains and losses. If that aggregation results in a net loss, the taxpayer may offset up to $3,000 against ordinary income in the current year. The remainder of the net capital losses may be carried over to other tax years to reduce the taxpayer’s tax liability.

Tax Rates on Realized Capital Gains

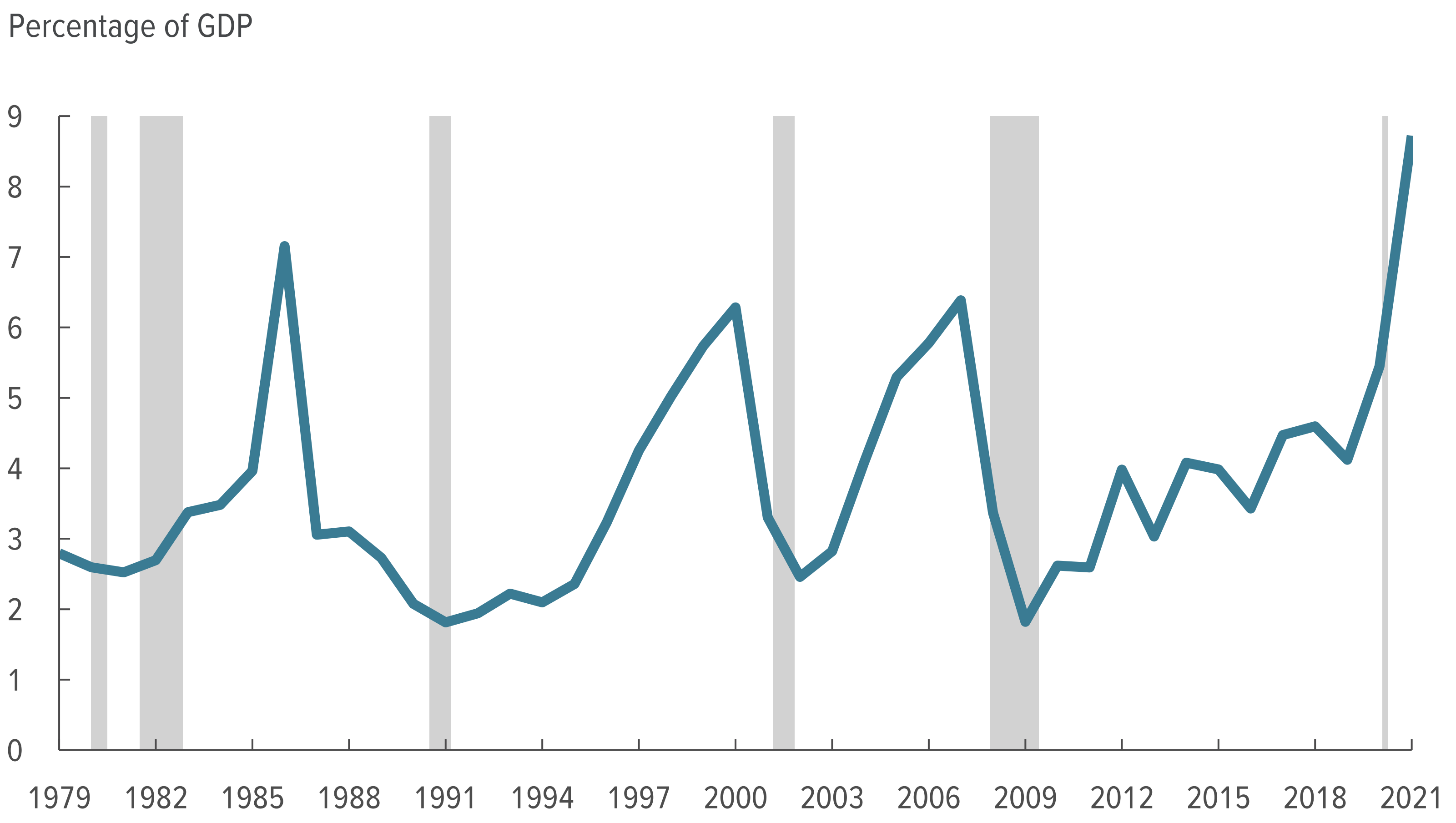
The tax rates that apply to capital gains vary by the type of asset and the length of time the taxpayer held the asset before selling it.

Short-Term Gains: Realized gains on assets held for less than a year are combined with a taxpayer’s other income and taxed at the same rate as ordinary income. The highest statutory tax rate on ordinary income is currently 37 percent.

Long-Term Gains: Realized gains on assets held for longer than a year are usually taxed at lower rates. The statutory rate on most long-term capital gains and qualified dividends is 0 percent, 15 percent, or 20 percent, depending on the taxpayer’s filing status and taxable income.

In addition, both short-term and long-term realized gains may be subject to the net investment income tax of 3.8 percent if the taxpayer’s income exceeds a certain threshold.

Realized Capital Gains as a Percentage of GDP



Realized capital gains are highly cyclical, and they vary more from year to year than other components of individual income. Gains have typically fluctuated between 2 percent and 7 percent of GDP in recent decades.

Processing data from the Internal Revenue Service (IRS) indicate that realized gains increased sharply in 2021, to 8.7 percent of GDP in CBO's estimate—the highest level in more than 40 years.

Data on individual capital gains beginning in 1995 are available at www.cbo.gov/data/budget-economic-data#7. For data before 1995, see Congressional Budget Office, *Capital Gains Taxes and Federal Revenues* (October 2002), Table 1, www.cbo.gov/publication/14077.

How Does CBO Project Capital Gains?

Realizations of Net Positive Capital Gains

To project individual income tax receipts, CBO projects taxpayers' realizations of net positive capital gains. That amount is the sum of all short-term and long-term capital gains minus losses (including loss carryovers) for all taxpayers whose gains exceed their losses.

Data on capital gains realizations reported on tax returns are available with a lag:

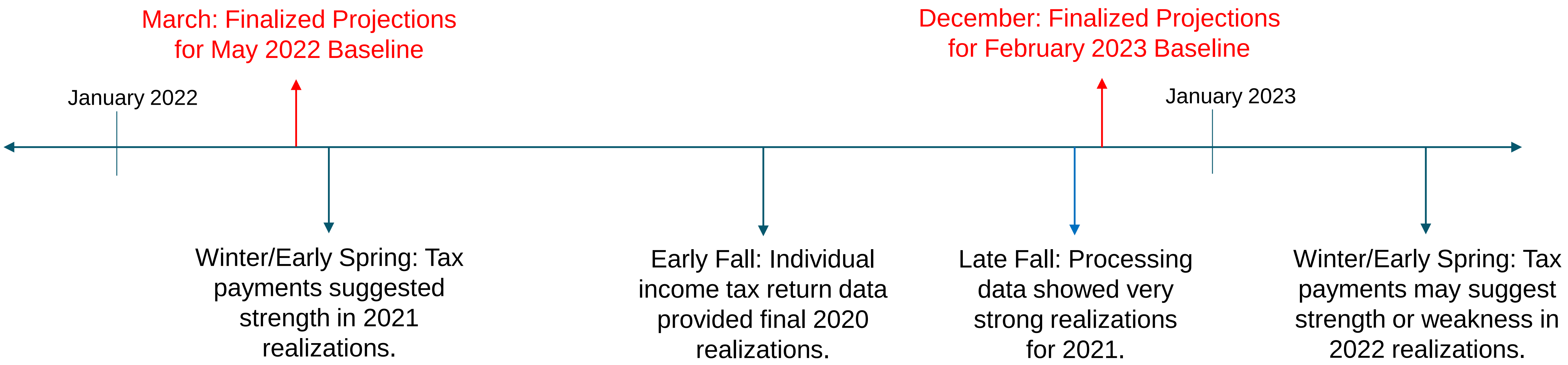
- The highest-quality data on capital gains realizations are from a nationally representative sample of individual income tax returns collected by the IRS. Those data are typically available about a year and a half after the end of a tax year. CBO received data on capital gains realizations for 2020 in fall 2022.

- The IRS produces monthly statistics, including the amount of capital gains realized by taxpayers, as it processes individual income tax returns. Reliable estimates are available about 11 months after the end of a tax year. CBO received the tabulations for 2021 in December 2022.

Data Issues and Limitations in Projecting Realized Capital Gains

CBO generally projects capital gains realizations each winter for its annual *Budget and Economic Outlook* and updates those projections the following summer. Because of the timing of data availability, CBO generally has little information about capital gains realizations in the most recent year.

For example, when CBO made its most recent projections, it had detailed tax return data for 2020 and some processing data for 2021, but it did not have much information about 2022 capital gains realizations.



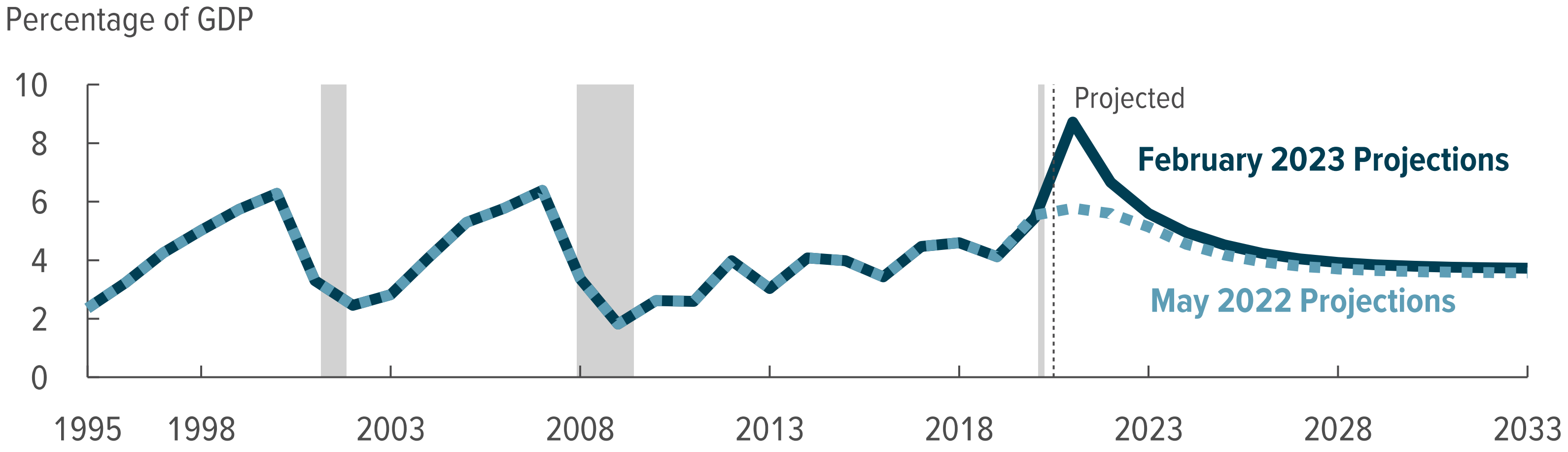
CBO's Methods for Projecting Realized Capital Gains

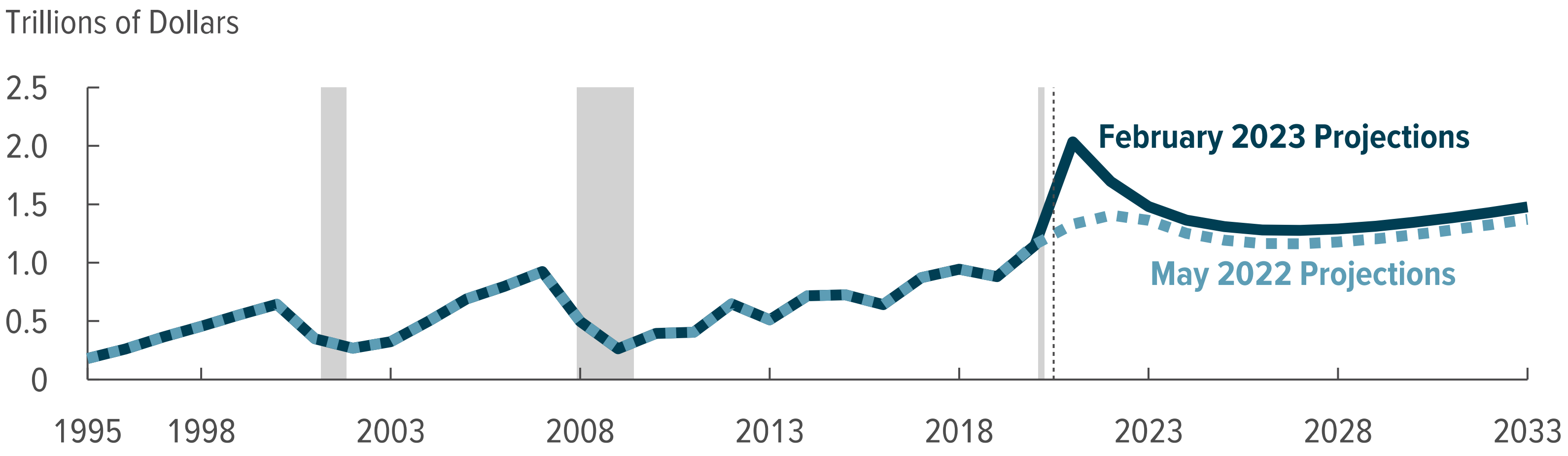
In CBO's projections for the longer term, capital gains realizations approach their historical average relative to the size of the economy, after adjusting for differences between historical tax rates and those in the projection period.

In the near term, however, gains are also expected to be influenced by asset values, aggregate investment, behavioral responses to anticipated changes in tax rules, and the current level of gains relative to their equilibrium level.

- If realizations are above their equilibrium level—one that is consistent with measures of the economy—CBO expects downward pressure on capital gains in the near term. Conversely, if realizations are below their equilibrium level, CBO expects upward pressure on capital gains in the near term.
- In CBO's February 2023 projections of realized capital gains, the near term includes 2023 and 2024. Those projections begin with 2021, the latest year for which the IRS's processing data are available, and then estimate subsequent years from CBO's projections of economic variables and expected changes in tax rates.
- CBO's projections of capital gains realizations are subject to a high degree of uncertainty, particularly about taxpayer behavior and the path of the economy and asset values.

CBO's February 2023 Projections of Capital Gains Realizations





The IRS's processing data indicate that capital gains realizations in 2021 probably exceeded $2 trillion, or 8.7 percent of GDP—their highest level in more than 40 years.

Those realizations were larger than CBO expected, given the performance of the stock market and existing data on investment and other variables.

CBO's February 2023 baseline projections incorporate that new information, which explained some of the recent strength in individual income taxes.

In the agency's projections, capital gains realizations gradually revert to about 3.7 percent of GDP over the next 10 years.

CBO's projections of receipts from individual capital gains are available at www.cbo.gov/data/budget-economic-data#7.

How CBO's Projections of Capital Gains Realizations Affect Projected Individual Income Tax Receipts

The share of individual income tax revenues that results from capital gains realizations is highly variable.

Receipts from capital gains accounted for about 9 percent of total individual income tax revenue, on average, before the 2008 financial crisis; afterward, in 2010, they decreased to about 5 percent. Since then, the share of receipts from capital gains has increased steadily.

CBO estimates that the portion of individual income tax receipts that resulted from capital gains exceeded 14 percent in fiscal years 2021 and 2022—much higher than is typically observed. That strength helps explain why individual income taxes measured as a share of GDP reached a historical high in fiscal year 2022.

In CBO's projections, tax receipts from capital gains decline as a share of individual income tax revenues. In fiscal year 2033, about 7.3 percent of individual income tax revenues is expected to come from capital gains realizations.

CBO's projections of receipts from individual capital gains are available at www.cbo.gov/data/budget-economic-data#7.

About This Document

This document was prepared to enhance the transparency of the work of the Congressional Budget Office and to encourage external review of that work. In keeping with CBO's mandate to provide objective, impartial analysis, the document makes no recommendations.

James Pearce and Naveen Singhal prepared the document with guidance from Edward Harris, John McClelland, Joseph Rosenberg, and Joshua Shakin. Sebastien Gay and Julie Topoleski provided comments. Omar Morales and Tess Prendergast fact-checked the document.

Jeffrey Kling reviewed the document. Rebecca Lanning edited it, and Casey Labrack created the graphics. The document is available at www.cbo.gov/publication/58914.

CBO seeks feedback to make its work as useful as possible. Please send any comments to communications@cbo.gov.