

Statement for the Record
Joint Hearing on Tax Reform and Tax Treatment of Capital Gains
United States Senate Committee on Finance
United States House Committee on Ways and Means
September 20, 2012

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By

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Thank you for this opportunity to contribute a Statement for the Record of the September 20, 2012, Joint Hearing on Tax Reform and Tax Treatment of Capital Gains by the United States Senate Committee on Finance and the United States House Committee on Ways and Means. As introduction, although one of the national organizations to which I belong (the Angel Capital Association, or ACA) appeared before you at the hearing, the testimony offered was arrived at through closed-door, back-room consultations and deliberations rather than any form of open debate and voting, and thus represents the sentiment of only an undefined portion of that organization's membership. As will be clear below, the ACA's recent testimony does not speak for me. I contribute these remarks as an individual citizen, investor and professional investment manager.

In full concord with my ACA colleagues, I agree that there is little or no doubt about the economic contributions and significance (including jobs, value and wealth creation) of Angel and Venture Capital investments in early-stage entrepreneurial enterprises. Furthermore I, like almost every other individual making such investments and realizing capital gains, will routinely and gladly take advantage of any preferential tax treatment made available. Nonetheless, addressing the topic of this hearing, I write to express the view, perhaps unusual among those in my position (but supporting the testimony of Mr. Stanfill at the hearing), that preferential capital gains tax rates are unnecessary, misguided and unwise public policy, and that their elimination rather than continuation would contribute significantly toward improving the fairness and justice of America's social fabric, as well as to an urgently needed solution for our pressing budgetary and fiscal dilemmas.

The gist of the present statement is that arguments (such as the ACA's) supporting the maintenance of preferential capital gains tax rates represent primarily the self-interest of the wealthiest few percent of our population masquerading and being presented as the public interest of the majority; in other words, the embarrassing and shameful rationalizations of a narrow and privileged special interest for continued favoritism and hand-outs from a public purse already burdened past the breaking point by other needs. The following are some of the salient arguments advanced by proponents of continued preferential capital gains tax rates, and the fallacies underlying each.

1. Investing in general, and early-stage private equity investments in particular, are so beneficial to the public good that they deserve to be specially incentivized by preferential capital gains tax rates. In response, does anyone really believe that investing is more beneficial to the overall public good, and more in need of incentivizing, than the work of teachers, health professionals, firefighters, truck drivers, etc., none of whose income is accorded such preferential tax treatment? All of these activities are worthwhile and necessary, but a dollar of income is a dollar of income, and should be taxed equally if in the same income bracket of a progressive tax system.

2. Early-stage private equity investing is so risky that it needs to be specially incentivized by preferential capital gains tax treatment in order for investors to undertake the risk. Indeed, there are individuals who say that they will choose to redirect their risky early-stage equity investments into safe and completely tax-sheltered bonds if capital gains should again become taxed at ordinary income rates. However, as the ACA is aware and has presented for years, aggregate data from at least eight academic studies (including some that the ACA itself has commissioned) report that the average return from Angel investing in groups is 27% per year. Even factoring in taxes, is it sensible or believable that sophisticated investors would choose a tax free 6% vs. a fully taxed 27% annual return, and should average citizens feel bad for and subsidize them so that they will not do so? If some investors do make this choice, both the tax-free bond market and the taxable equity market will undoubtedly each adapt and in some ways even benefit. Finally, the proposition that businesses with risky individual transactions deserve to be tax advantaged does not lead to beneficial tax treatment for the gambling industry.

3. Preferential tax treatment of capital gains is not new policy, but merely a time-honored part of the tax code that should be continued as status quo. While partially true about being a time-honored part of the tax system (preferential capital gains tax rates have come in and out historically), our country has reached a dangerous and unsustainable fiscal and budgetary impasse by enacting all expenditures, while resisting all income measures, that are favored or resisted individually by a politically sufficient set of self-interested advocates pro or con. In other words, the sustainability and health of the entire system are usually not addressed when making decisions about individual programs or choices, or if made, the painful tradeoffs are not honored in fact.

Preferential capital gains tax treatment has played a clear role in bringing us to the present crisis, and reflexively maintaining it will only worsen rather than help ameliorate our current unsustainable situation.

In summary, preferential income tax rates on capital gains are inherently the narrow self-interest of the already wealthy, are unnecessary for inducing ambitious and energetic investors to reach for the more-than-sufficient returns of early-stage private equity, and have played a significant role in creating both the growing social inequity and current fiscal disaster in our country. In the name of our children and grandchildren, please consider eliminating preferential capital gains tax rates (and a number of their derived problems) entirely, for the broadest and long-term public good of all our citizens. I thank you in advance for your attention.