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NET CAPITAL GAINS ACROSS ZIP CODES

Benjamin H. Harris and Lucie Parker
Urban-Brookings Tax Policy Center
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ABSTRACT

This brief examines net capital gains realizations by utilizing zip-code level data on taxes and demographics. This data can help shed light on direct beneficiaries of preferential capital gains tax rates beyond the standard distributional tables based solely on income. In particular, this brief highlights the extent to which the benefits are concentrated among zip codes, and the limited benefits of preferred rates for certain geographic regions. We focus on the relationship between capital gains and Adjusted Gross Income (AGI), the demographic characteristics of zip codes with a particularly high percent of tax returns reporting capital gains, and the average capital gains reported across counties.

The opinions expressed here are solely those of the authors and do not necessarily reflect the views of the Urban-Brookings Tax Policy Center.

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I. INTRODUCTION

Capital gains are the profits from sales of capital assets, such as corporate stock, real estate, or businesses. The taxation of capital gains is exceptionally complex, with a separate schedule of tax rates depending on taxpayers' marginal income tax bracket and length of asset ownership, type of asset, and other factors. Long-term capital gains, which apply to assets held for more than one year, enjoy preferential treatment under the tax code. Between 2004 and 2012, top statutory tax rates on most long-term capital gains were at the lowest levels since the Great Depression. Taxpayers above the 15 percent individual income tax bracket faced a 15 percent capital gains tax rate, while taxpayers in the 15 percent tax bracket or below faced a capital gains tax rate of zero. Beginning in January 2013, the tax rates on both short-term and long-term capital gains rose for high-income taxpayers.[1]

Capital gains taxes, including the tax preference for income classified as capital gains, introduce a host of distortions and complexities. Notable economic impacts of capital gains taxation include a "lock-in" effect (i.e., disincentive to realize capital gains), incentives to shelter income away from income taxation, and a "double tax" on corporate profits. While the responsiveness of capital gains realizations to capital gains tax rates is subject to debate, one prominent study showed that the impact is primarily constrained to the short-run.

The goal of this brief is to examine net capital gains realizations[2] by utilizing zip-code level data on taxes and demographics. This data can help shed light on direct beneficiaries of preferential capital gains tax rates beyond the standard distributional tables based solely on income. In particular, this brief highlights the extent to which the benefits are concentrated among zip codes, and the limited benefits of preferred rates for certain geographic regions. In the following sections—which are based on 2012 data, the most recent year for which data are available—we focus on the relationship between capital gains and Adjusted Gross Income (AGI), the demographic characteristics of zip codes with a particularly high percent of tax returns reporting capital gains, and the average capital gains reported across counties.

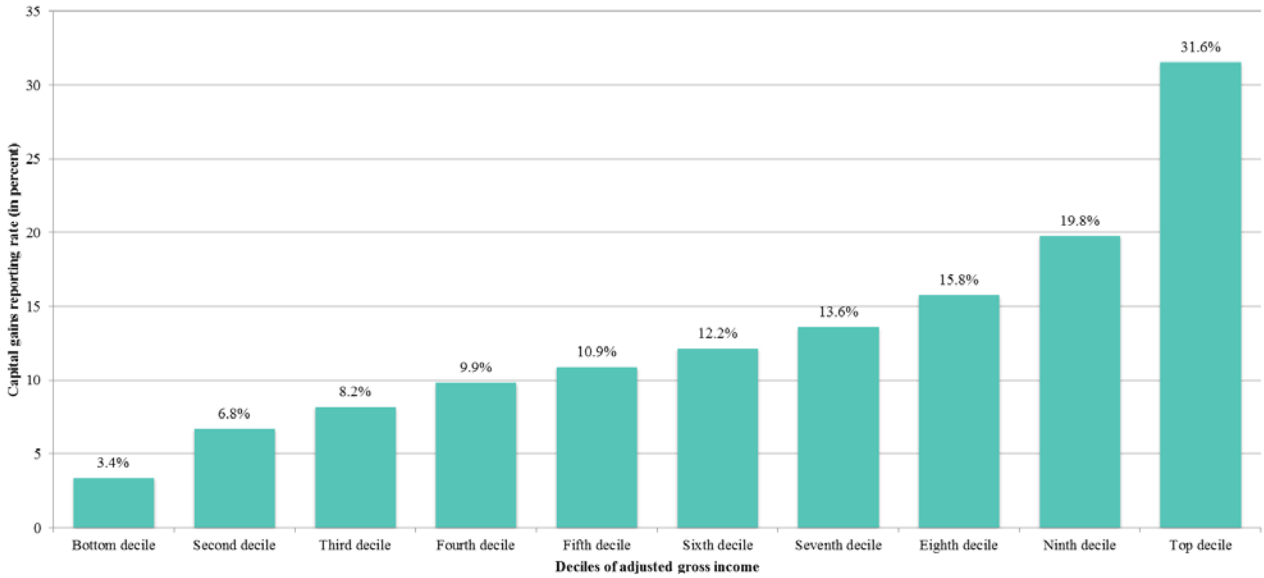
II. NET CAPITAL GAINS AND ZIP-CODE LEVEL INCOME

Not surprisingly, the share of tax returns reporting capital gains—the capital gains reporting rate—rises with income (Figure 1). In 2012, between the bottom and ninth income deciles of zip codes ranked by mean AGI, the reporting rate increased steadily from 3.4 percent to 19.8 percent. Capital gains reporting was markedly higher in the top income decile, at a rate of 31.6 percent.

[1] These increases can be attributed to several changes in tax law, including an additional tax on investment income for high-income taxpayers established by the Affordable Care Act and a higher tax rate on capital gains, relative to 2012 rates, established by the American Taxpayer Relief Act of 2012.

[2] Throughout this brief, the term "capital gain" refers to capital gain less loss as reported on line 13 on the 2012 IRS Form 1040.

Figure 1. Capital Gains Reporting Rate by Zip-Code Adjusted Gross Income

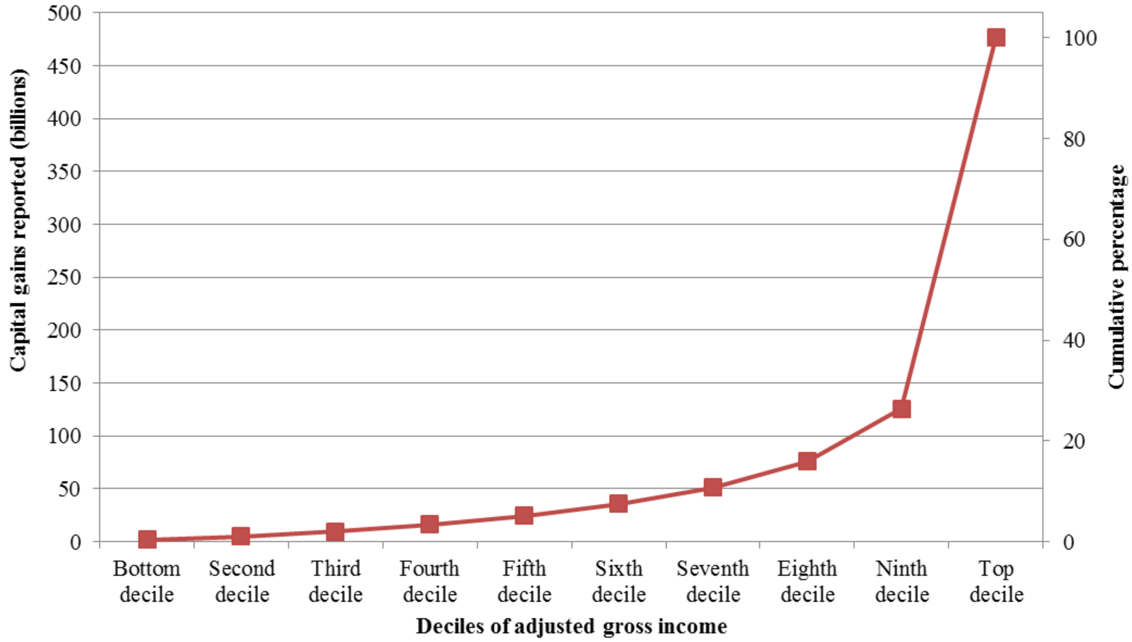


Source: Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: The capital gains reporting rate is equal to the number of tax returns reporting capital gains divided by the total number of tax returns within a given zip code. Capital gains data are derived from SOI (2014) and are for tax year 2012. Adjusted gross income is equal to aggregate AGI in the zip code divided by the number of filers and weighted by the number of tax returns in a given zip code. Zip codes that filed fewer than 300 tax returns are excluded from the analysis.

As might be expected, aggregate capital gains are concentrated in high-income zip codes since higher-income taxpayers are more likely to hold corporate stocks directly, rather than in retirement accounts, and to hold much larger amounts of assets more likely to yield capital gains subject to tax. While homeownership is more widespread than corporate stock, most gains on homes are not subject to taxation.

The concentration of capital gains by zip code is stark. In 2012, nearly three-fourths of capital gains (73.6 percent) were reported by the 16.4 percent of filers residing in zip codes in the top AGI decile (Figure 2). Lower-income zip codes reported a small share of capital gains; the bottom 50 percent of zip codes by income, representing 40.5 percent of filers, reported just 5.2 percent of capital gains in 2012.

Figure 2. Cumulative Distribution of Reported Capital Gains

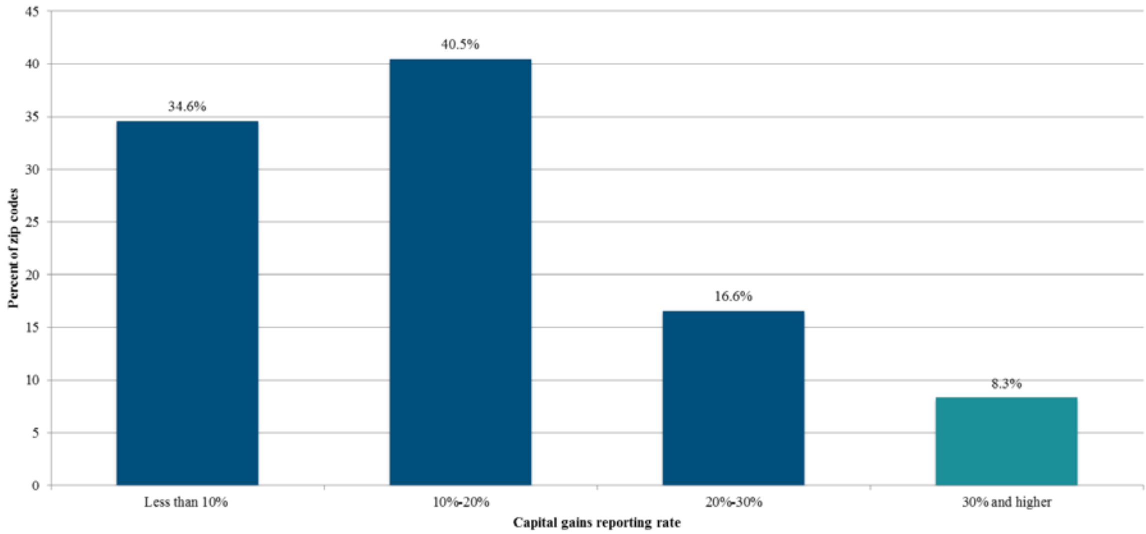


Source: SOI 2014; authors' calculations.

III. CHARACTERISTICS OF ZIP CODES WITH HIGH REPORTED CAPITAL GAINS

The capital gains reporting rate varies across zip codes. In 2012, the vast majority of zip codes had mean capital gains reporting rates of less than 20 percent, while in 37.6 percent of zip codes less than 10 percent of filers reported capital gains and in an additional 42.0 percent of zip codes the reporting rate was between 10 percent and 20 percent (Figure 3). In 14.2 percent of zip codes, between 20 percent and 30 percent of filers reported capital gains; only 6.1 percent of zip codes maintained capital gains reporting rates of 30 percent and higher.

Figure 3. Zip-Code Capital Gains Reporting Rate



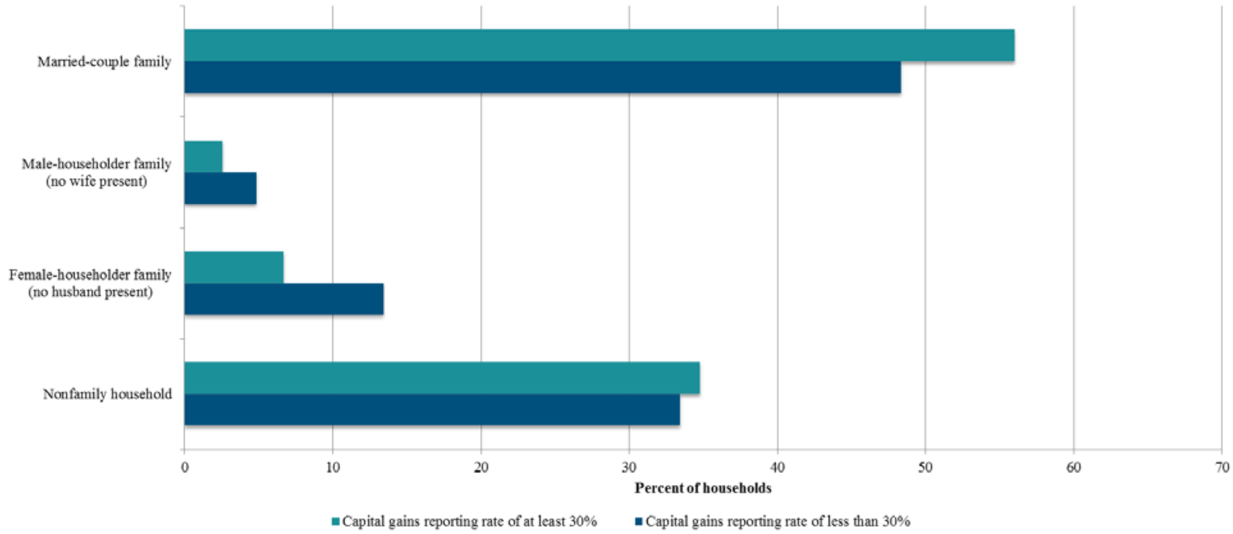
Sources: SOI 2014; authors' calculations.
Note: The capital gains reporting rate is equal to the number of tax returns reporting capital gains (less loss) divided by the total number of tax returns within a given zip code. Data are derived from SOI (2014) and are for tax year 2012.

Differences in demographic characteristics between those zip codes with capital gains reporting rates above and below 30 percent are shown in Figure 4. Although the two groups have relatively similar shares of nonfamily households (34.8 percent of households in high-reporting zip codes and 33.4 percent in sub-30-percent report rate zip codes), the two are dissimilar in their percent share of married-couple families, male-householder families with no wife present, and female-householder families with no husband present. In 2012, for those zip codes with high reporting rates, 56.0 percent of households were married couple families (versus 48.3 in the remaining zip codes), an additional 2.6 percent of households were male-householder families (versus 4.8 percent) and 6.7 percent were female-householder families (versus 13.7 percent).

Figure 5 illustrates the differences in age composition between low- and high-reporting zip codes in 2012. Those zip codes with mean capital gains reporting rates of 30 percent and over tended to be younger on average than those with sub-30-percent rates. For example, 53.4 percent of the population in high-reporting zip codes was 35 and older, compared to 61.1 percent of the population in low-reporting zip codes.

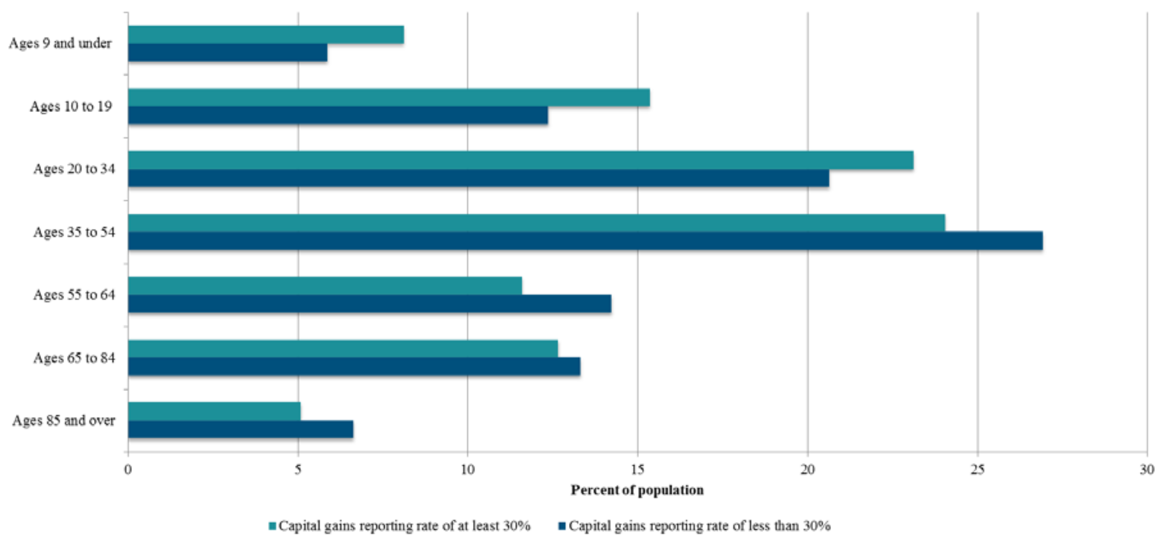
Finally, those zip codes with capital gains reporting rates greater than or equal to 30 percent also differ in race composition (Figure 6). The African-American population of high- reporting zip codes was just 3.3 percent, while the white population of these zip codes was 83.2 percent. In contrast, among the lower-reporting zip codes, 13.4 percent of the population was African American and 73.4 percent of the population was white. An additional 9.3 percent of the population among the high-reporting zip codes was Asian (compared to 4.5 percent in the remaining zip codes), and 1.6 percent was comprised of other races (compared to 5.1 percent).

Figure 4. Household Composition by Zip-Code Level Capital Gains Reporting Rate



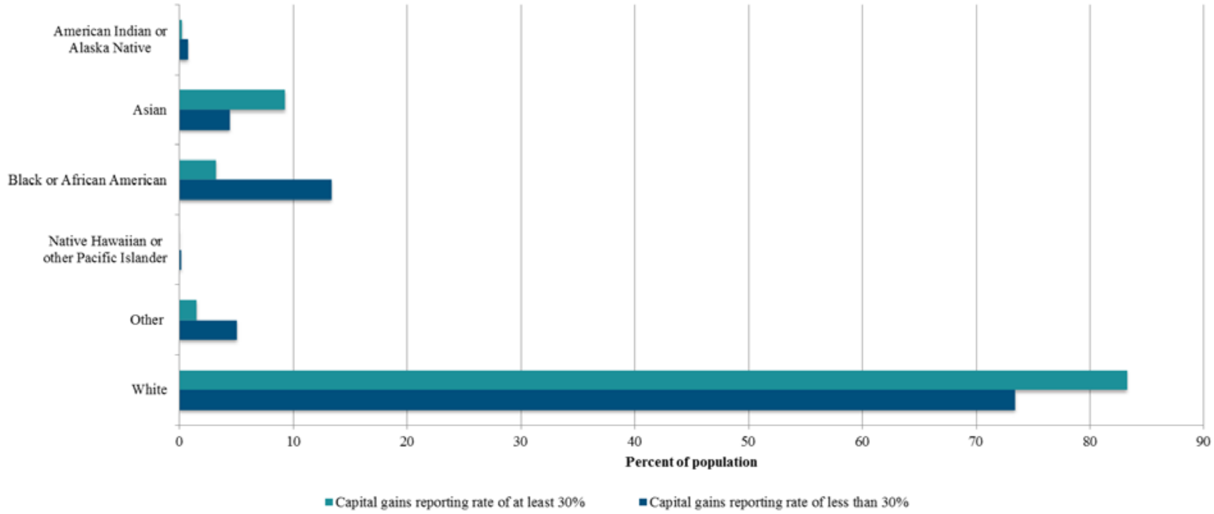
Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: Household types are weighted using the total households in each zip code. The capital gains reporting rate is equal to the number of tax returns reporting capital gains (less loss) divided by the total number of tax returns within a given zip-code. Data are derived from SOI (2014) and are for tax year 2012. Household data are derived from U.S. Census Bureau (n.d.) and are five-year estimates from 2008–2012.

Figure 5. Age by Zip-Code Level Capital Gains Reporting Rate



Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: Age groups are weighted using the total population in each zip code. The capital gains reporting rate is equal to the number of tax returns reporting capital gains (less loss) divided by the total number of tax returns within a given zip-code. Data are derived from SOI (2014) and are for tax year 2012. Age group data are derived from U.S. Census Bureau (n.d.) and are five-year estimates from 2008–2012.

Figure 6. Race by Zip-Code Level Capital Gains Reporting Rate

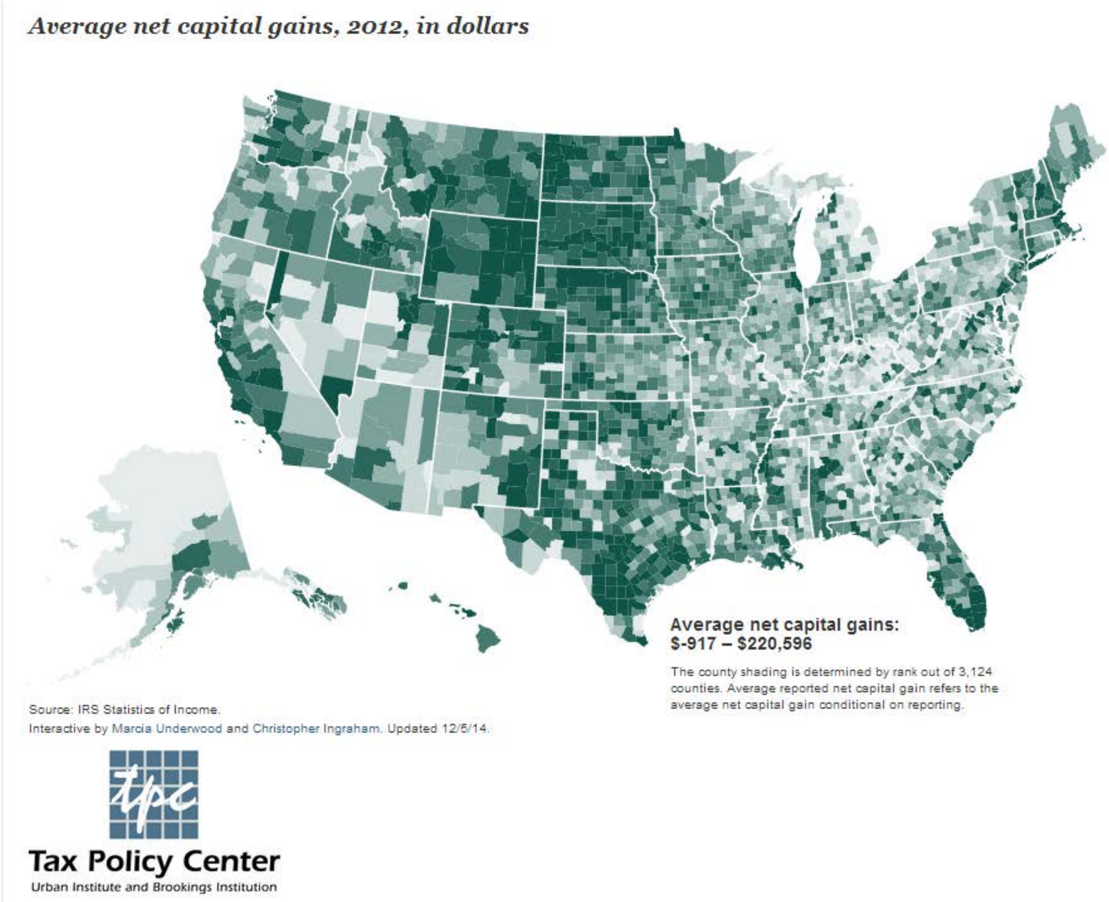


Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: Racial composition is weighted using the total population in each zip code. The capital gains reporting rate is equal to the number of tax returns reporting capital gains (less loss) divided by the total number of tax returns within a given zip-code. Data are derived from SOI (2014) and are for tax year 2012. Race data are derived from U.S. Census Bureau (n.d.) and are five-year estimates from 2008–2012.

IV. COUNTY-LEVEL VARIATION IN REPORTED CAPITAL GAINS RATES

The share of taxpayers reporting capital gains varies substantially across counties. While the median county-level capital gains reporting rate is 13.7 percent, the bottom 10 percent of counties have a reporting rate of 7.3 percent, compared to 22.2 percent for the highest 10 percent of counties. The variation is likely driven by differences in demographics, levels and composition of income, and trends in occupation.

Reporting rates vary substantially by geographic location, and are much higher in coastal counties and those located in the Midwest. The high coastal reporting rates are likely driven by higher levels of income, which is correlated with higher rates of capital gains realizations. The high reporting rates in the Midwest are likely driven by the agricultural sector, which exhibits rates of capital gains reporting that are roughly twice that of other taxpayers. Counties in the Southeast, which have high rates of poverty, exhibit lower reporting rates than those in other regions.



V. CONCLUSION

Tax preferences for capital gains totaled over $100 billion in 2012, but the capital gains reported on tax returns were unevenly distributed across geographic areas, in large part according to the income of the residents. Taxpayers in 10 percent of zip codes reported nearly three-fourths of the aggregate capital gains reported on tax returns in 2012. Zip codes with high reporting rates tended to be disproportionately white, young, and married. Counties along the coasts and in the Midwest reported markedly higher reporting rates than those in other regions.