

The Capital Gains Preference: An Analysis of Economic Efficiency, Equity, and Reform Alternatives

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Abstract: *The preferential tax treatment of long-term capital gains is a cornerstone of many countries' tax systems, including that of the United States. This policy is primarily justified on the grounds of promoting economic efficiency by encouraging investment, mitigating the "lock-in" effect, and adjusting for inflation. On the other hand, it faces significant criticism for exacerbating income inequality and reducing the progressivity of the tax code. This paper combines a review of the economic literature, an analysis of historical tax data, and a comparative policy study in a mixed-methods approach to evaluate the trade-offs inherent in the capital gains preference. The findings indicate that the efficiency arguments are theoretically sound, but their empirical support is mixed and often outweighed by substantial equity concerns. The paper concludes that the current structure in the U.S. is suboptimal and proposes a set of reforms, including a tiered inclusion system based on asset holding periods and the harmonization of rates for very high-income earners, to better balance the goals of efficiency and equity.*

Keywords: Capital Gains, Taxation, Efficiency, Equity, Lock-in Effect, Income Inequality, Tax Reform

