Q: How impactful would an increase in capital gains be?

Brian Lockhart: The answer depends heavily on whether you are evaluating from a political or economic perspective. Few would doubt that it is a smart political move by Biden and is consistent with the “rich need to pay their fair share” theme of his campaign. The data is somewhat mixed on the economic impact or the impact it is likely to have on the markets. The tax increases are substantial for many taxpayers, with gains being taxes at 43.4% versus 23.8% today. If you live in a high tax state like California, your combined taxes on capital gains is over 55%.

I believe any negative impact is more likely to be felt in the economy than the stock market. Any impact on the stock market is likely to be transitory as wealthy investors sell positions with large gains so they are taxed at current levels instead of proposed levels. A UBS report suggests there is little relationship between changes in capital gains rates and stock market performance. One reason for this is that almost 75% of stocks are held in non-taxable accounts like IRAs and 401ks, according to Bloomberg data.

What politicians often neglect to take into account is that capital has no borders -- just ask California and New York who are seeing residents flee high tax states. Tesla to Texas and Goldman Sachs to Florida are just two examples of high profile companies choosing low-tax venues to operate out of. A tax system that favors consumption over savings and investment creates fewer opportunities for people, especially those not already wealthy.

Clint Pekrul, CFA: The Biden administration is pushing for a meaningful change in the capital gains tax rate. The tax on long-term capital gains would increase from the current rate of 20% to 39.6%. I am not sure how they came up with their number, but let us just call it 40%. Essentially, the Biden administration is doubling the tax rate on long-term capital gains. In my opinion, this change could be disruptive. Consider the gains we have had across asset classes over the past decade. Equity indexes like the S&P 500 have more than doubled. Interest rates have plummeted, so bond prices have appreciated. Investors in general are sitting on an enormous pile of capital gains, helped in large part by the Federal Reserve’s monetary policies over the past decade.

Now, the federal government wants to swoop in and tax these gains away. Meanwhile, we are still printing money and will do so in response to any disruptive market event. It seems like a bad cycle. Ultimately investors will find ways around paying the full tax through various loopholes. I understand the motivation behind the capital gains tax hike proposal, but at the end of the day it will likely fall short of raising the revenue that politicians expect. Meanwhile, the prospect of a higher capital gains tax rate down the road might motivate some investors to sell today. Biden unveiled his tax plan during his campaign, so his actions should not be a surprise. But now that prospect might become a reality.