Statement of Senator Carl Levin (D-Mich.)

on

Introducing the Closing the Derivatives Blended Rate Loophole Act

Jan. 23, 2012

Mr. LEVIN. Mr. President, the coming year is certain to be focused on two problems: the need to restore prosperity for American working families, and the need to reduce our budget deficit. Our challenge is to accomplish these goals together, and not to pursue one at the expense of the other. As I have said repeatedly to this Senate, I believe the only way we can successfully achieve both goals is to pursue deficit reduction strategies that do not rely solely on slashing federal spending and attacking programs that help build opportunity for the middle class. We must recognize that revenue, as well as spending cuts, must be part of our strategy, and we must ensure that the sacrifices that surely will be needed to reduce the deficit fall not just on middle-class Americans, but are spread equitably, and ask for contributions from those who have benefitted so greatly from policies enacted in the past.

Today I introduce the Closing the Derivatives Blended Rate Loophole Act. This bill meets the twin tests of helping to reduce the deficit while promoting the interests of American families. It would put an end to a tax loophole that epitomizes how our tax code too often favors short-term speculation over investment in economic growth and job creation. This loophole showers benefits on short-term traders of certain financial instruments, but does nothing to promote economic growth and raises the tax burden on American families.

What is the derivatives blended rate? It's an example of how the complexities of the tax code can grant breaks for the few at the expense of the many. Here's how it works.

Generally speaking, taxpayers are allowed to claim the lower long-term capital gains tax rate on earnings only if those earnings come from the sale of assets that they have held for more than a year. The reason is simple: we tax long-term capital gains at a lower rate because we want to encourage the long-term investment that helps our economy grow.

But under Section 1256 of the Internal Revenue Code, traders in certain derivatives contracts have managed to win themselves an exemption from the distinction between short-term and long-term capital gains. Under this section, traders in those derivatives can claim 60 percent of their income as long-term capital gains, no matter how briefly they hold the asset. This "blended" tax rate applies if the trader holds the asset for 11 months or 11 hours.

The details may be complex, but the bottom line is that this treatment bestows a substantial tax break on those who typically hold the covered derivatives for only a brief period. It encourages and rewards short-term speculation in complicated financial products and does little, if anything, to help our economy grow and create jobs. In fact, the increasing focus of our financial markets on short-term profit through trades that last just minutes or seconds threatens real damage to our economy. This speculation is hardly the sort of activity that our tax code should subsidize.

We also lose significant tax revenue by allowing this tax break – a revenue loss that means we must either ask for more from American families, or add to the deficit. What's more, this misguided policy contributes to the basic unfairness that characterizes too much of our tax code, by providing an unusual and unnecessary tax break to a small group of financial speculators. Instead of encouraging growth and investment, these loopholes contribute to what Warren Buffett has called the "coddling" of the wealthy and well-placed.

Mr. President, closing this loophole is a common-sense, mainstream idea. I ask my colleagues to heed the advice of the tax experts at the American Bar Association's Tax Section, who wrote in December to the tax-writing committees of the House and Senate:

> "We are aware of no policy reason to provide preferential treatment for these gains and losses. Lower capital gains rates are intended to encourage long-term investments in capital assets such as stock. Whatever the merits of extending preferential rates to derivative financial instruments generally, we do not believe that there is a policy basis for providing those preferential rates to taxpayers who have not made such long-term investments."

Ending this loophole by passage of the Closing the Derivatives Blended Rate Loophole Act would not solve all the problems in our tax code, nor end our deficit dilemma. But it would be another important step toward a saner, fairer tax code. It would demonstrate that Congress shares the concerns of so many Americans that the tax system is too often stacked against the interests of working families and in favor of the privileged few. It would end a policy that encourages short-term speculation over long-term investment in growth. And it would provide a down-payment on the revenue we need to restore if we're to engage in serious deficit reduction and avoid slashing critical programs. I urge my colleagues to join me in the effort to pass it.