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Chapter 5

CAPITAL GAINS AND LOSSES AND THEIR DISTRIBUTION, 1917-1946

1 NATURE AND SOURCES OF DATA

The data reviewed in this chapter consist largely of tabulations of figures individuals entered on their income tax returns. The net capital gains and losses thus reported year by year are far from perfectly comparable for the 30 years 1917-46, for they were affected by changing statutory provisions and by certain gaps and changes in the government's tabulations. To reduce the effects of these sources of heterogeneity, we made various adjustments and supplied estimates to fill some of the blanks in the published data. By these adjustments and estimates, described in detail in Appendix One, we obtained a continuous series of figures possessing a useful, though by no means close, approach to homogeneity.

In the discussion that follows, and in the tables, 'net capital gain' and 'net capital loss' refer to all net gains and losses from the sale of assets not part of the taxpayer's stock-in-trade, as reported on federal income tax returns, whether or not they were specifically defined as 'capital' gains and losses in the statutes applicable to particular years. That is, we ignored the statutory exclusion in 1922-23 of assets held 2 years or less from the category of 'capital' assets, the exclusion in 1938-41 of assets subject to an allowance for depreciation, etc. Our figures are the net capital gains and losses realized on sales or taxable exchanges of all such assets as tabulated from the returns and published in *Statistics of Income*, with the adjustments referred to. Despite our adjustments, the annual statistical series reflect variations in the statutory treatment. Consequently, for some purposes we treat separately the statistics for each of the 5 periods marked off by major statutory differences: 1917-21, 1922-33, 1934-37, 1938-41, and 1942-46.

2 LARGE AMOUNTS OF CAPITAL GAINS AND LOSSES EXCLUDED FROM THE DATA

A major effect of the statutes upon the statistics has been to exclude very large amounts of both 'realized' and 'unrealized' appreciation and depreciation in the market values of capital assets.

First, capital gains realized since but representing appreciation accruing before March 1, 1913, the effective date of the first revenue act under the 16th Amendment, have not been taxable or included in our figures, though the comparable losses have been treated and reported like any other capital losses. Section 113 (a) (14) of the Internal Revenue Code provides that if a gain is realized on property acquired before March 1, 1913 and the seller's cost or other basis is less than the fair market value of that date, the latter value shall be the basis for measuring the taxable gain. On the other hand, if the property is sold at a loss, the ordinary rules for measuring a loss apply, with no exclusion of that part of the loss that accrued before March 1, 1913. Consequently, substantial amounts of realized capital gains, but not of realized capital losses, have been excluded from our figures.

Second, the statutes do not take account of changes in the value of capital assets, however large, unless the change is converted into a 'realized' profit or loss by actual sale or taxable exchange. For example, the capital gain of about \$29 million realized by the late Senator Couzens upon the sale of his stockholdings in the Ford Motor Company in 1919 got into the figures, but the larger 'unrealized' gains enjoyed by Henry Ford and his wife did not. Their gains will never get into the figures because they died without selling their holdings. As we noted, the unrealized capital gains and losses embodied in the value of the property transferred at death are not regarded by the statutes as thereby 'realized' by the decedent, his estate, or the individual heirs. For this reason, very large amounts of capital gains and losses incorporated in family property holdings have never gotten into the income tax figures.¹

¹ Such avoidance of taxes on capital gains is in many, but not all, cases partly offset by increases in estate taxes. Other things being equal, the value of an estate will be higher by the amount of capital gains taxes avoided, and the estate will therefore be subject to larger taxes. The offset is only partial and may be wholly absent because (a) only a tax rate as high as 100 percent against the portion of the estate arising from the avoidance of capital gains taxes would be sufficient for a full offset, whereas the actual rates have of course been less; (b) estates equal to or less in value than the exempted amount are not taxed at all, regardless of the unrealized capital gains they may include;

Much of the appreciation and depreciation from cost in the values of properties transferred by gift (*inter vivos*) has likewise been excluded by the statutes. The transfer of property by gift is not regarded by the law as occasioning realization of gain or loss by the donor. The donee, in turn, does not report a gain or loss as long as he retains the property, and he never reports any if he holds the property until his death. If he sells the property he must, under the existing statute, include on his income tax return as a gain or loss the difference between the amount he realizes by sale and the donor's cost.² Previous statutes have differed in their treatment of gifts, with the result that varying proportions of the actual appreciation or depreciation in market value of properties transferred by gift were excluded from income tax returns. Even when realized by sale, no appreciation is recognized for tax purposes if the donee is a tax-exempt institution.

The provisions of the successive income tax statutes with respect to tax-free exchanges and reorganizations have also had the effect of excluding considerable amounts of appreciation and depreciation in capital assets from the reported figures because the relevant gains and losses have not been regarded as technically 'realized'. For example, a man who builds up a chain of grocery stores, then sells the chain to a larger chain-grocery enterprise, at a big profit, but arranges the transaction in the form of a tax-free reorganization and takes payment in the latter's shares of stock, is not regarded as 'realizing' a capital gain unless and until he sells this stock. If he dies without selling the stock, and his heirs sell it later, no gain is ever reported for the appreciation in the value of his investment that occurred up to his death.

Finally, the figures reported for income tax purposes naturally do not include the capital gains and losses realized by individuals who were not required to file returns under the different statutes because they received net or gross incomes smaller than various specified amounts. Because individuals reporting net incomes under \$5,000 generally accounted for sizeable proportions of aggregate

(c) instead of increasing his taxable estate by the amount of the tax avoided, the decedent may have increased his spending by a part or all of it.

² Except that the market value of the property at the time of the gift, if less than the donor's cost, must be substituted for the latter in measuring a loss. For example, if Smith gives his son securities having a market value of \$10,000, for which Smith originally paid \$20,000, and the son sells them for \$5,000, the latter's allowable loss is \$5,000, not \$15,000.

net capital gains and losses, it seems probable that those not required to file returns also realized substantial amounts. For the years before 1928 the gains and losses of individuals who reported no net income are excluded because the relevant data were not compiled for them, and no data are available on the excess of short term losses over short term gains in 1938-41, for these were not allowed as deductible items by the statutes during this period and the amounts were not tabulated.³

3 NET GAINS EXCEEDED NET LOSSES ONLY MODERATELY DURING THE PERIOD AS A WHOLE

Net capital gains realized during the 30 years by individuals filing income tax returns and reporting net incomes, including taxable fiduciaries' returns, totaled approximately \$50 billion, and for returns reporting no net income about \$0.7 billion (Table 1). The tabulated total of net capital losses was approximately \$23 billion for individuals reporting net incomes and \$9 billion for those reporting no net income. (These are the sums of the annual net balances of gains over losses or losses over gains for each taxpayer reporting transactions in capital assets, not the totals of gross capital gains or losses.) As will be recalled, the net losses incurred by individuals who reported no net income for years before 1928 and the excesses of short term losses over short term gains in 1938-41 are excluded because the amounts have not been tabulated or published and because we could not devise satisfactory means of estimating them in detail. If they were included, the total net losses would probably reach or exceed \$35 billion. In short, about 69 percent of the net capital gains realized by individuals and taxable fiduciaries during these 30 years seem to have been offset by their net capital losses, and the excess of gains would appear to have been only about \$16 billion.

4 UNREALIZED GAINS MAY HAVE GREATLY EXCEEDED UNREALIZED LOSSES

It might seem that the net result of all the 'sound and fury' of capital gains transactions during these 30 years, involving many hundred billions of dollars in purchases and sales, was relatively small. Some persons might be inclined to infer that capital gain and loss transactions are of minor importance and that it makes little difference how they are treated by the tax laws. No such inferences would be just-

³ For further discussion of the deficiencies in the comparability of the data for the various subperiods, see Appendix One, Part I, Sections D and E.

fied. For one thing, there are reasons to suspect that the 'unrealized' capital gains excluded from the figures because the technical legal criteria of realization were not met exceeded the net losses similarly excluded. Second, even if capital gains and losses actually canceled in the aggregate, the evidence suggests that such a balance was not achieved either for most individuals or even for the main large groups of persons engaging in capital transactions.

Comprehensive quantitative evidence to confirm the suspicion that aggregate unrealized capital gains exceeded unrealized losses does not exist; a study of the gains and losses embodied in a large number of estates upon the deaths of the owners would be one way of obtaining quantitative evidence on this point. In its absence certain qualitative considerations supporting the suspicion cannot be ignored.

First, as noted above, realized capital gains representing appreciation accrued before March 1, 1913 have not been recognized for tax purposes or included in our figures, though the comparable capital losses have been treated and included as ordinary capital losses.

Second, we know that the timing of the realization of capital gains is more subject to choice than the timing of the realization of losses. Defaults, bankruptcies, margin calls, and the desire or necessity to stop a loss from growing frequently compel the technical realization of losses at specific times, whereas analogous situations that compel the technical realization of capital gains at unwanted times are less common. Thus, capital losses were notably heavy in the crisis and depression years 1920-21 and 1929-33. Approximately half of the net capital losses of individuals reporting no net income in 1928-46 was concentrated in the 3 years 1930-32. For many taxpayers much of the net loss did not reduce their income taxes because they did not have enough taxable income to use up their deductible net losses. Nevertheless, they were forced to realize their losses. This difference tends to cause a larger proportion of potential losses than of gains to be 'realized'.

Further, as far as the timing of realization has been at the taxpayer's discretion, tax considerations have offered a greater inducement to postpone or avoid the realization of gains than of losses. When realized, the gains have been subject to tax while the losses have been allowed as deductions from taxable income only in varying and usually limited degree. In some years between 1917 and 1946 the deductibility of capital losses was restricted to the amount

of realized gains, or to realized gains plus \$1,000 or \$2,000. Such restrictions doubtless caused individuals to try to defer the realization of losses in years when they were not realizing gains, and to speed the realization of gains to the extent that losses were being realized in any given year. But this type of provision tended also to speed the realization of losses, when possible, to the extent that gains were being realized. And it left intact the influential considerations that as long as the realization of net capital gains (gains in excess of deductible losses) was deferred, the taxpayer retained the use of funds that would otherwise go to the government in taxes, and that if the postponement lasted until death, the capital gains tax would be avoided forever; whereas postponing the realization of losses could yield a tax advantage only if the losses were subsequently realized in a year when offsetting gains also were realized or when the statute permitted a more liberal deduction of losses.

The privilege open to individuals in earlier years of making *inter vivos* gifts to children and others free from gift and estate taxes and in the later years of making them at lower rates of tax than those applicable to bequests, together with the lower income taxes payable when the income from a given amount of property was shared by several members of a family than when received by a single member, strongly promoted the distribution of wealth within families. But since a tax was payable on gains realized upon the sale of property even if the proceeds were transferred as gifts, whereas no tax was payable either by the donor or donee on capital gains embodied in gifts of the property itself as long as the donee retained possession, gifts 'in kind', on which the capital gains remained 'unrealized', were favored over gifts in cash. No such considerations impeded the realization of capital losses. Indeed, reverse considerations were influential, for taxes could usually be reduced by realizing losses.

The use of tax-free exchanges and reorganizations, so-called, as a means of converting properties, heavy with unrealized capital gains but lacking good marketability, into listed securities with excellent marketability was conspicuous during many of these 30 years; and this practice also, as noted above, had the effect of avoiding the technical realization of capital gains.

In some cases the realization of large capital gains and losses was indefinitely deferred or forever avoided for reasons unconnected with tax considerations: the desire to keep a controlling interest in a business enterprise — because of family tradition or the salaries, power, and other perquisites of control — or the desire to transmit

specific income-yielding properties to heirs. But properties retained for these reasons were also much more likely to embody capital gains than losses.

The effects of two motives for postponing the realization of capital losses, as far as the timing was discretionary with the investor, should also be weighed: (a) The varying limitations on the deductibility of *net* losses doubtless caused some deferring of final realization pending a year in which the losses could be used in full to offset capital gains. (b) Many persons are reluctant to make the final acknowledgment of error implicit in 'taking' a loss. As long as the loss is not actually realized, no bookkeeping confession is necessary, and the possibility of a happy reversal in prices may continue to be cherished.

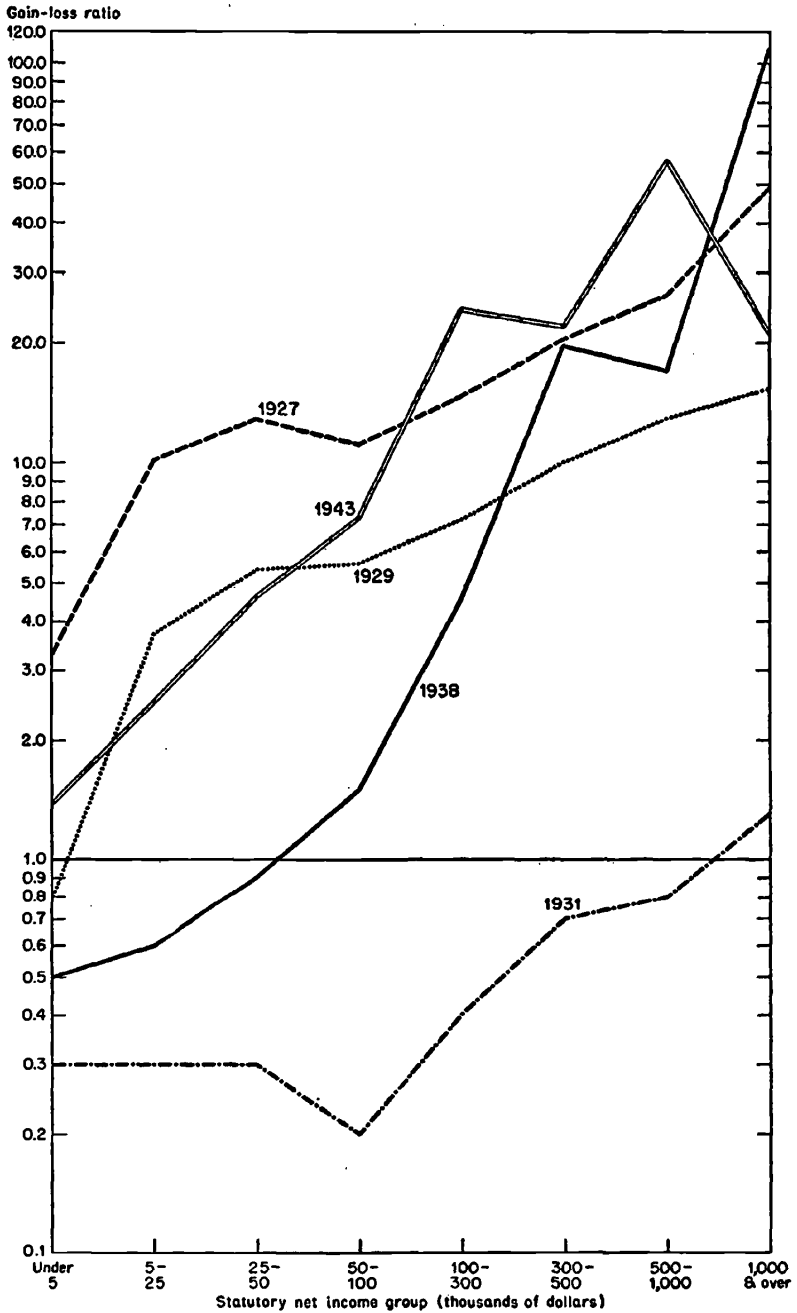
On net balance, the foregoing considerations lead us to believe it highly probable that total unrealized capital gains significantly exceeded total unrealized capital losses during these 30 years.

5 MODERATE EXCESS OF TOTAL GAINS OVER LOSSES CONCEALS WIDE VARIATIONS IN INVESTORS' EXPERIENCES

Unfortunately, we cannot show conclusively to what extent the moderate excess of capital net gains over losses 'realized' in 1917-46 hides significant differences in the experience of individuals and groups of investors because the statistics aggregate the experience of large and varying numbers of individuals classified in each year by the amount of their income. Except for special groups, the figures do not trace the experience of identical individuals for a long period. Consequently, we have to be content with three pieces of fragmentary evidence which, as far as they go, corroborate the general impression that capital gains and losses do not cancel for individuals or for most groups.

First, taxpayers with larger statutory net incomes, i.e., including net capital gains and losses, generally reported a more favorable ratio between their capital gains and losses than those with smaller incomes (Chart 5 and Table 4). In 1929, for example, individuals with statutory net incomes under \$5,000 reported net capital gains only eight-tenths as large, in the aggregate, as their net capital losses, whereas those with net incomes of \$25,000-50,000 reported net capital gains 5.4 times their net capital losses, the \$300,000-500,000 group, 10 times, and the \$1 million and over group, 15.3 times. The same general pattern, with only occasional irregularities, is found in the other years since 1926.

Chart 5
 Net Capital Gain-Loss Ratio by Statutory Net Income Groups



Source: Table 4.

Ratio scale

The fact that substantial capital gains by themselves lifted many individuals into higher brackets of statutory net income, thereby giving the higher income groups the benefit, statistically, of these gains, severely diminishes the value of the figures for this purpose. As respects losses the figures are better for our present purpose because in 1924-33 net capital losses segregated for tax credit were not deducted in determining the net income classification, and in subsequent years statutory limitations on the deductibility of net capital losses prevented any substantial downward shift in the income classification of the losers.

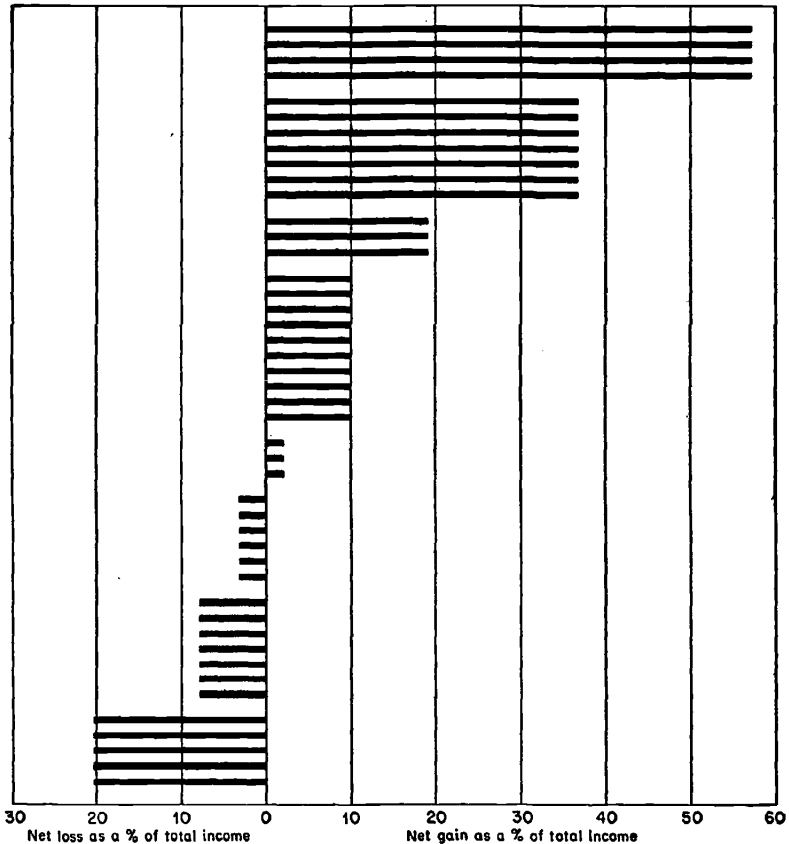
The second piece of evidence is the distribution of net capital gains and losses by the 'other income' of the recipient, i.e., income excluding net capital gains and losses, in the only year for which data have been tabulated, 1936. In that year, one of rising stock prices and of a considerable excess of capital gains over losses, the ratio between capital gains and losses was more favorable for persons with fairly high incomes, over \$30,000, than for those with smaller incomes (Table 68). As we do not have any reason to believe this relationship was peculiar to 1936 we suspect that over a long period, such as the 30 years 1917-46, when total realized capital gains only moderately exceeded realized capital losses, individuals in the higher brackets of 'other income' made considerable net capital gains as a group while those in the other income brackets, in the aggregate, either made only small gains or suffered losses.

The third, and in some respects most pertinent, fragment of information is supplied by the net capital gains and losses in 1917-33 of 45 individuals, each of whom had a statutory net income of \$1 million or more in 1924. Data respecting their experience became available through a study made by the staff of the Joint Committee on Internal Revenue Taxation in 1938.⁴ Since these 45 individuals are all those among the 75 reporting incomes of \$1 million or more in 1924 whose returns for all 17 years were available, the selection is unbiased except that unusual capital gains in 1924 may have led to the inclusion of some individuals who did not have a very substantial income from other sources in either that or other years. For the entire 17 years the 45 individuals had net capital gains of \$187 million; if unreported losses in 1932 and 1933 were taken into account, the figure might be somewhat reduced, though in all likelihood not below \$150 million. What is more significant, as may be seen in Chart 6 and Table 84, is that the total net gain is by no

⁴ *Million Dollar Incomes* (Government Printing Office, 1938).

Chart 6
45 Persons with Million Dollar and Over Incomes in 1924
Net Capital Gains and Losses as Percentages
of Total Incomes, 1917-1933

To avoid the possibility of revealing the identity of anyone, yet indicate their varying fortunes, the 45 taxpayers are divided into 8 groups on the basis of the proportions their net gain or loss bore to their total income for the 17 years. Each horizontal line represents one taxpayer; its length, the average percentage net gain or loss of his group.



Source: Table 84.

means evenly distributed among the 45 individuals and that there is little tendency for net gains in one year to be offset by net losses in another year. As a result, 27 individuals had a net gain for the entire period aggregating \$253 million, while 18 showed an excess of losses of \$66 million. The net gains of the 27 ranged from less than 5 to more than 50 percent of their total incomes (before negative and deduction items) for the 17 years, while the net losses of

the 18 ranged from less than 5 to 25 percent of their total incomes.

In addition to these fragments of direct evidence, a more general piece of statistical evidence to the same effect is the great irregularity from year to year in the relative amounts of aggregate net capital gains and losses. The 'twenties were favorable for making capital gains; the early 'thirties, unfavorable. Those who retired from speculative and investment activities or who died during the prosperous 'twenties did not get a chance to suffer offsetting losses during the depressed early 'thirties; and many who incurred severe losses in the latter period — as from investments in bonds that subsequently went into default — had not shared significantly in the large capital gains of the 'twenties.

6 ANNUAL CAPITAL GAINS AND LOSSES FLUCTUATE WIDELY

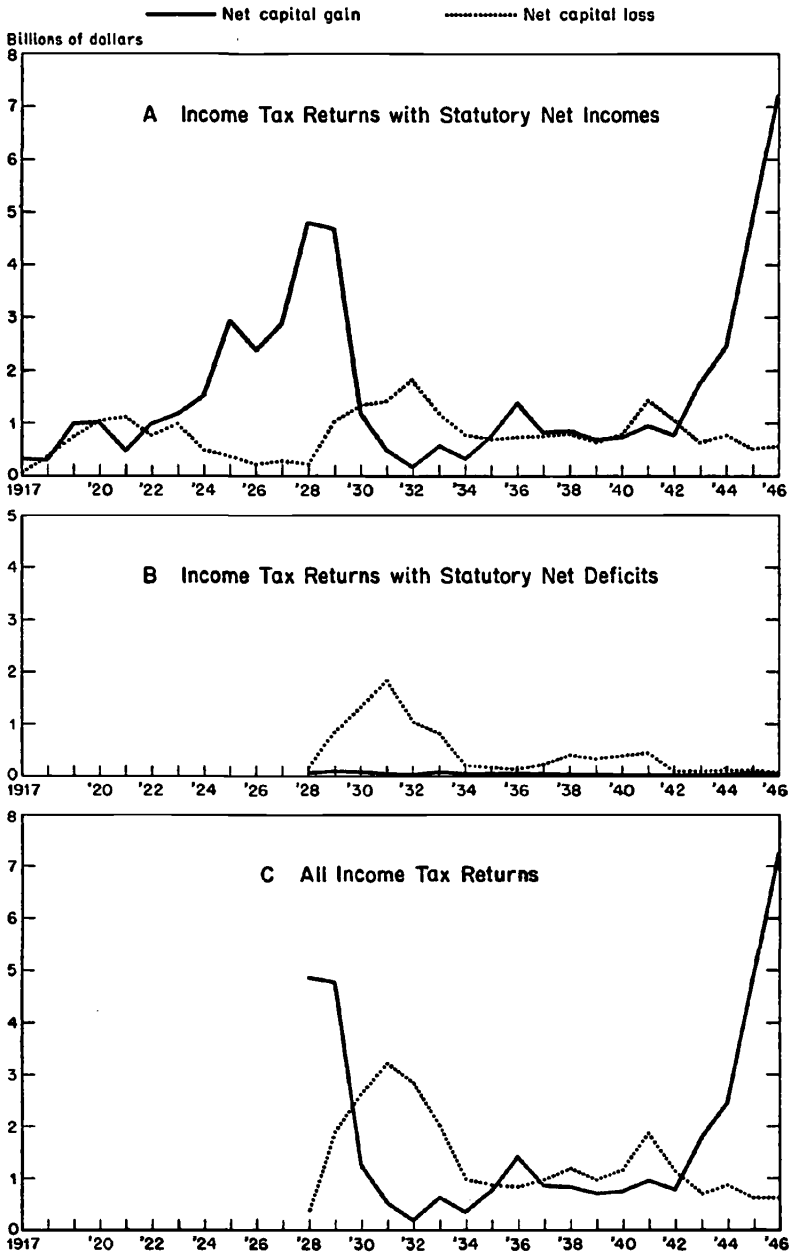
Net gains and losses fluctuated widely during the 30 years (Chart 7 and Table 1). Net gains rose to peaks of \$4.8-4.9 billion in 1928, 1929, and 1945, and to \$7.3 billion in 1946; in 1932 they fell to \$184 million. The peak years for net losses were 1931 and 1932, when \$3.2 and \$2.9 billion respectively, were reported.

In Chart 2 and Table 5 net gains and losses are expressed as percentages of the net income reported on all returns with net incomes. For individuals with net income, net gains were 19.1 percent of their net income in 1928 and 18.9 percent in 1929; then the percentage dropped sharply. In 1932 it was only 1.4, and the net losses of net income reporting individuals constituted 15.6 percent of their net income.

7 TOTAL GAINS AND LOSSES FOLLOW STOCK MARKET MOVEMENTS

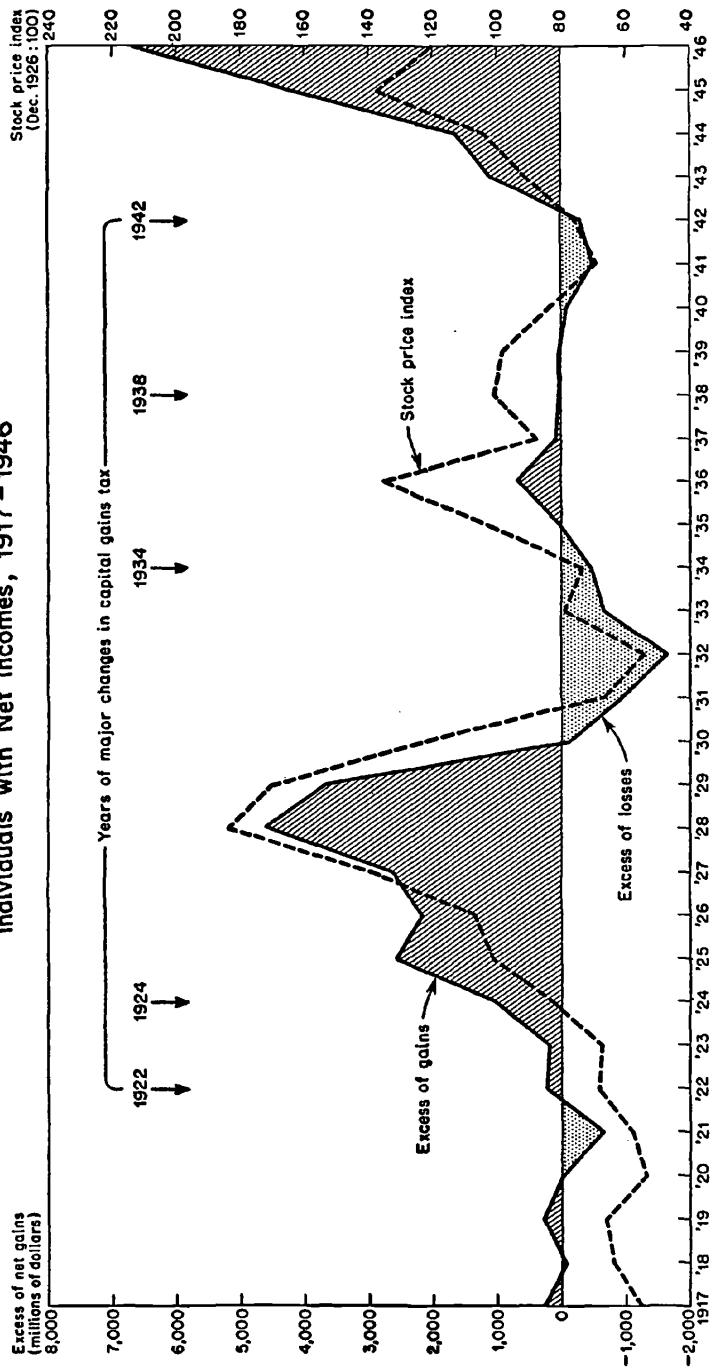
Since security transactions account for the major portion of capital gains and losses (Sec. 10), and since the stock market also reflects changes in the prevailing attitude toward capital assets in general, it is not surprising to find a general, though far from perfect, correspondence between fluctuations in capital gain and loss realization during the 30 years and the movements of security prices on the New York Stock Exchange (Tables 1 and 15). During the boom years 1924-29, when capital gains reached high levels and losses were relatively small, stock market prices were moving steadily upward. During the depression years 1930-32, when gains and losses showed the opposite picture, the trend in stock market prices was markedly downward. In the next 5 years, net gains, like the stock price index, rose in 1933, fell in 1934, rose in 1935 and 1936, and fell again in

Chart 7
Net Capital Gains and Losses
1917 - 1946



Source: Table 1.

Chart 8
Stock Price Index and Excess of Net Capital Gains or Losses
Individuals with Net Incomes, 1917 - 1946



Source: Table 1; Stock Price Index from Table 15.

1937. (But from 1939 through 1941 when gains rose, the index fell.) The excess of capital gains over losses for individuals with net incomes shows the same general responsiveness to stock price movements (Chart 8). *Short term* net gains and losses followed stock price movements much more closely than *total* (Sec. 9).

8 DISTRIBUTION OF CAPITAL GAINS AND LOSSES BY INCOME GROUPS

Differences in the net income classification for the various periods rule out precise income level comparisons of annual data in *Statistics of Income*. In 1924-33 net capital losses segregated for tax credit were not deducted in determining the net income classification; nor in 1932-33 were short term net losses from transactions in stocks and bonds; in 1934-37 the taxpayer applied certain percentages to realized net gains and losses to determine the statutory amount taken into account in the net income classification, and deductible net loss was limited to \$2,000; in 1938-41 realized net gains and losses were again reduced by applying certain statutory percentages, and all short term net loss was disallowed as a deduction in determining net income; and in 1942-46, somewhat different statutory percentages were in force as well as somewhat altered limitations upon the deductibility of net losses. Nevertheless, after allowing for all such variations, certain generalizations with respect to the relation between differences in income levels and capital gains emerge, and certain more limited statements may even be made about capital losses.

Capital gains a small part of aggregate net income but a major source of large incomes

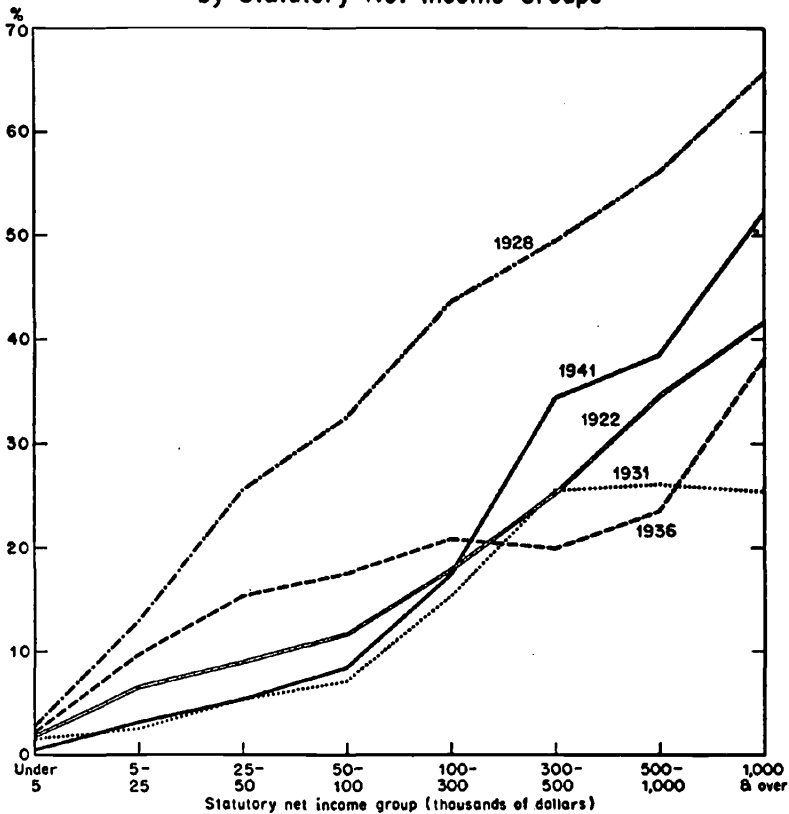
As noted, for the 30 years as a whole, net capital gains constituted less than 5 percent of the aggregate net income of individuals reporting net income but in 1928 and 1929 they approximated 19 percent, while in each of 6 other years, they shrank to less than 2 percent (Charts 2 and 3; and Tables 5 and 6).

Although capital gains constitute only a small proportion of the aggregate income of the taxpaying community as a whole, they are a major source of large individual incomes. In this respect they are similar to dividends, rents, and royalties, which are also among the smaller sources of income in the aggregate but among the major sources of large incomes. In the peak year 1928 net capital gains constituted 49.4 percent of the aggregate net income reported by those with statutory net incomes of \$300,000-500,000, 56.1 percent for the income group \$500,000-1,000,000, and 65.7 percent for the income group \$1 million and more (Table 5); and for 1917-46 as

a whole, as noted, they accounted for nearly a third of the aggregate net income of individuals with statutory net incomes of \$100,000 or more, and half of the total for those with \$1 million or more (Chart 3 and Table 6).

The relatively greater importance of capital gains as a source of income at high than at low net income levels is illustrated for 5 years in Chart 9 and Table 5. Although the 5 years differed radically with respect to the tax rate on capital gains and total net gains realized, capital gains were a bigger source of larger than of smaller incomes in all. This was most pronounced in 1928, when the stock market boom was in full swing and net capital gains reached a new peak. The progressive importance of capital gains as we ascend the income

Chart 9
 Net Capital Gains as Percentages of Net Income
 by Statutory Net Income Groups



Source: Table 5.

scale is even more marked when short term gains are excluded, for, in contrast to long term gains, short term gains did not tend to increase as a proportion of net income above the income level \$50,000-100,000 (Table 12).

Greater part of capital gains realized by taxpayers in other than the highest income groups

Although capital gains are far more important as sources of larger than of smaller incomes, the greater part of net capital gains in the aggregate is usually realized by individuals in the middle income groups. How net capital gains were shared by the different income groups in each of the 5 periods 1918-21,⁵ 1922-33, 1934-37, 1938-41, and 1942-46 is shown in Chart 10 and Table 3. Higher income taxpayers did relatively better in 1922-33 than before or since. Those with net incomes in excess of \$50,000 accounted for just over half of net gains in 1922-33; in 1918-21 for 10 percent, in 1934-37 for 28 percent, in 1938-41 for 38 percent, and in 1942-46 for 27 percent. The income group \$5,000-25,000 together with the group below \$5,000 accounted for 81 percent of net gains in 1918-21, 37 percent in 1922-33, 58 percent in 1934-37, 52 percent in 1938-41, and 62 percent in 1942-46. In this respect also the distribution of capital gains is much like that of dividends. Dividends too are received in larger aggregate amount by taxpayers with middle-size incomes than by those with large incomes, yet are relatively far more important sources of larger than of smaller incomes (Chart 11 and Table 7).

Capital gains unevenly distributed within each income group as well as between income groups but the average amount and the proportion of taxpayers enjoying them rise sharply as we move up the income scale

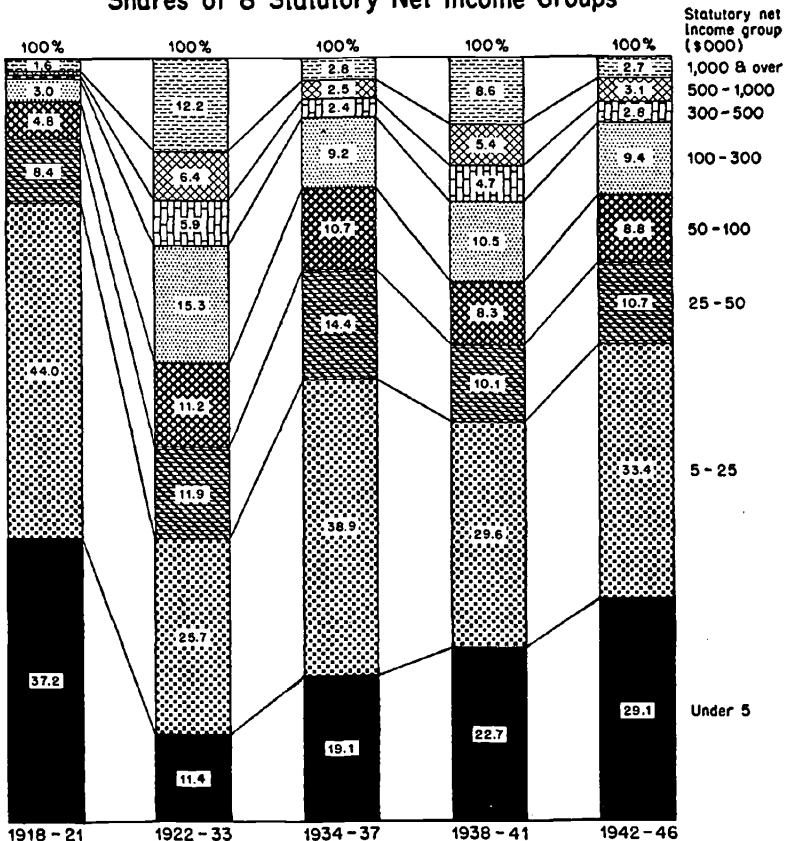
Capital gains constitute a bigger source of income at higher than at lower income levels because the proportion of individuals receiving them rises and the average gain increases as we ascend the income scale. Many taxpayers in all income groups do not receive any capital gains whatever. For example, only 27 percent of the taxpayers with statutory net incomes of \$5,000-25,000 reported net capital gains in 1936. The proportion was 50 percent in the \$25,000-50,000 group, and 59-64 percent in the groups above \$100,000. Average net capital gains for taxpayers reporting them in 1936 rose

⁵ The period 1918-21 is used rather than 1917-21 because the distribution of net capital gains by net income groups available for 1917 is not as detailed as that shown for later years.

sharply from about \$3,000 in the \$5,000-25,000 net income group to \$10,000 in the \$25,000-50,000 group, \$55,000 in the \$100,000-300,000 group, \$126,000 in the \$300,000-500,000 group, \$282,000 in the \$500,000-1,000,000 group, and to about \$1.5 million in the \$1 million or more group (Chart 12 and Table 79). Gains-realizing taxpayers in this highest income group reported net gains more than 400 times as large, on the average, as those with net incomes of \$5,000-25,000.

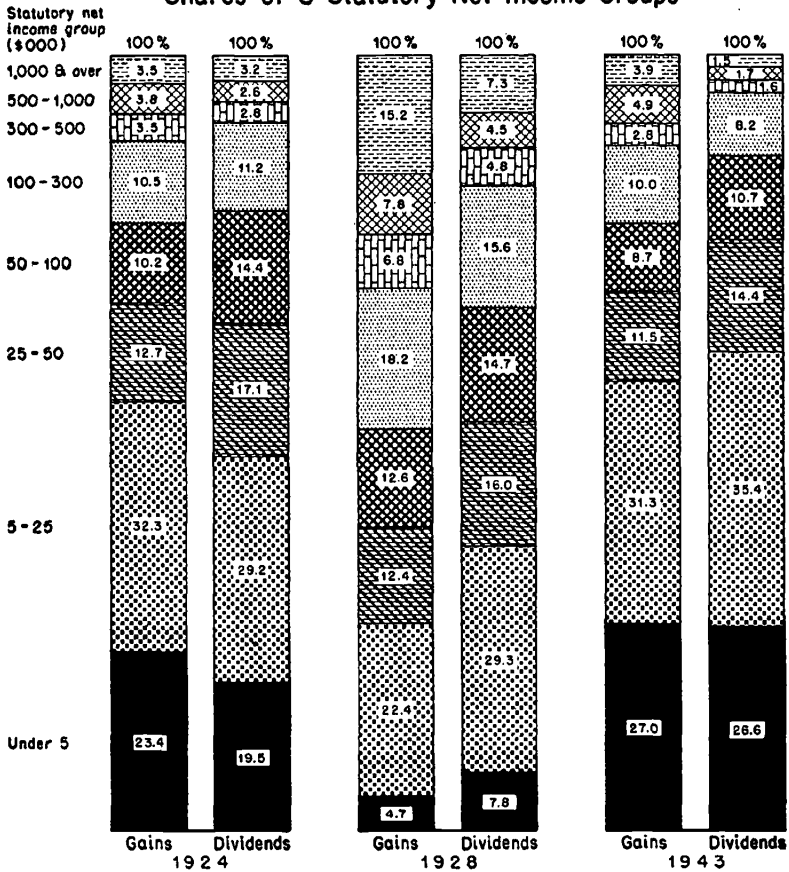
Many individuals reach higher income levels mainly because of capital gains
 Many taxpayers reach the higher levels solely or mainly because of

Chart 10
 Net Capital Gains
 Shares of 8 Statutory Net Income Groups



Source: Table 3.

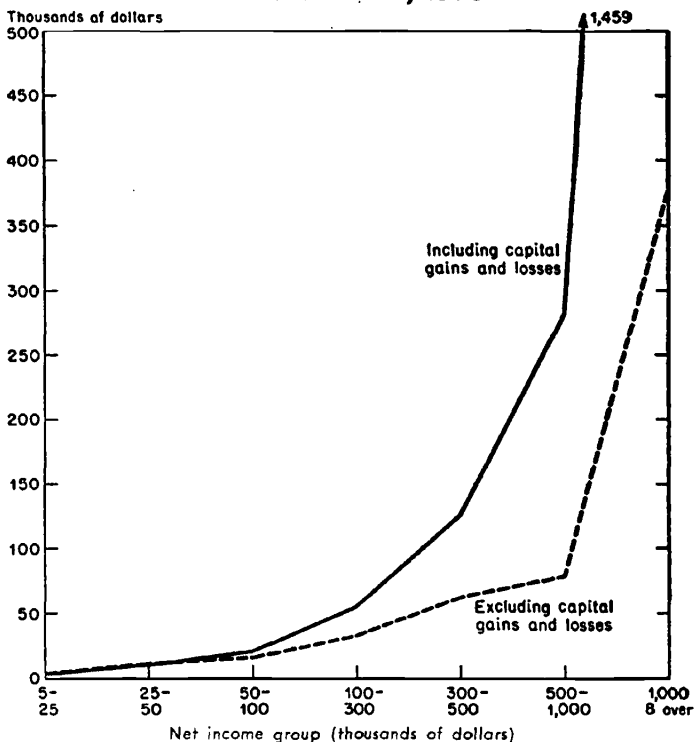
Chart 11
Capital Gains and Dividends
Shares of 8 Statutory Net Income Groups



Source: Table 7.

capital gains. In Chart 12 and Table 79 net incomes including and excluding capital gains are compared with respect to the percentage of taxpayers reporting net capital gains and the average size of the net gains in each income group. As the notes to Table 79 indicate, precise comparisons are not possible because of differences in the original tabulations, but rough comparisons may usefully be made. Both the average net gain and the proportion of taxpayers reporting net gains are substantially larger in every income group above \$50,000 in the classification based upon income including net capital gains than in the classification based upon income excluding gains.

Chart 12
 Average Net Capital Gain by Statutory Net Income Groups
 Including and Excluding Statutory Net Capital
 Gains and Losses, 1936



Source: Table 79.

In other words, net capital gains are important in pushing people up into the higher income groups.

Very substantial capital gains relative to 'other' income characteristically, though doubtless with many exceptions, arise from appreciation that has occurred over a long period but is realized legally in the single year the assets are sold. This is especially marked in the very highest income groups. A not uncommon occasion for a taxpayer's realization of an extremely large gain in a single year is the sale to the public, with the aid of investment bankers, of a large interest in what had previously been a family enterprise or similar closely held business corporation. The capital gain so realized forces the taxpayer into a higher income group than his usual one. The sale by a large stockholder of a substantial block of

stock in a widely owned business corporation (the motive of the sale sometimes being to diversify investment holdings or avoid a subsequent forced sale after death to raise funds to pay federal and state death taxes) may have a like result. In 1934-37, for example, assets held more than 10 years were responsible for 79 percent of the aggregate net capital gains of individuals reporting statutory net incomes of \$1 million or more, and for 56 percent in the case of individuals with incomes of \$500,000-1 million (Table 19). The average amount of net capital gains realized from assets held longer than 10 years in the \$1 million or more income groups was \$1,459,500; in the \$500,000-1,000,000 group, \$315,600 (Table 38).

But those who receive larger incomes from other sources also realize larger capital gains on the average

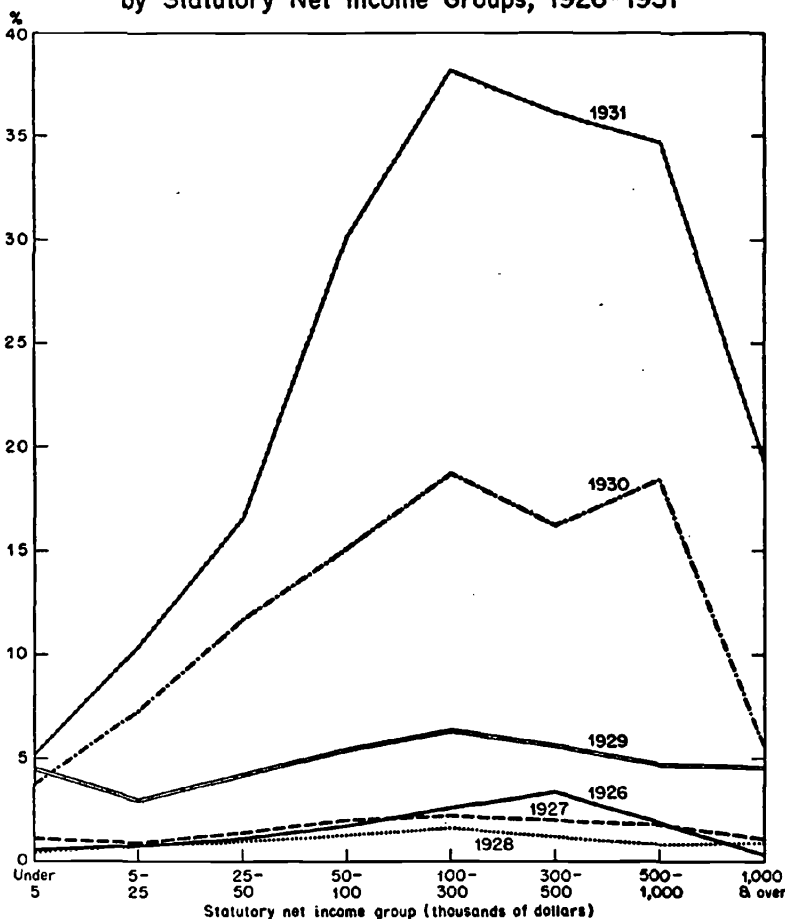
While these and similar types of transaction are prominent in causing capital gains to bulk large as a source of income in all the higher income groups, it also appears to be true, as indicated by the special tabulations available only for 1936, that those who receive the largest incomes from other sources tend on the average to enjoy the largest capital gains (Chart 12 and Table 79). The average gain realized was approximately \$4,000 for individuals reporting net incomes of \$5,000-30,000 exclusive of capital gains and losses; \$11,000 for the \$30,000-50,000 income group; \$16,000 for the \$50,000-100,000 group; \$32,000 for the \$100,000-300,000 group; \$62,000 for the \$300,000-500,000 group; \$78,000 for the \$500,000-1,000,000 group; and \$375,000 for those with \$1 million or more. Naturally, however, the average realized gain is smaller on this basis of income classification, and the progression less sharp, because taxpayers for whom large capital gains constitute the main source of income are no longer automatically in the top income groups but tend to be scattered among the various groups. The average realized gain on assets held more than 10 years in the 3 uppermost income groups in Table 80 is roughly 2½ to 3 times as large when income including capital gains and losses is the basis of classification as when capital gains and losses are excluded.

Some evidence that the largest net losses in relation to total income are sustained neither by the top nor the bottom group filing income tax returns

Net capital losses segregated for tax credit were not deducted in determining the net income classification in 1924-33, as noted above, and varying amounts of net losses were not taken into account in determining the net income classifications for subsequent years.

For these reasons, comparisons of the relative importance of net capital losses at different income levels over a period of years are considerably blurred. Despite this limitation, there seems to have been some regularity in pattern when net losses are expressed as a percentage of the net income reported on the returns for each income group. From 1926 through 1931 this percentage increased as net income (based on the statutory definition, i.e., without regard to segregated net losses) rose up to about the \$100,000-300,000 level, then declined as net income rose (Chart 13 and Table 5). The pat-

Chart 13
 Net Capital Losses as Percentages of Net Income
 by Statutory Net Income Groups, 1926-1931

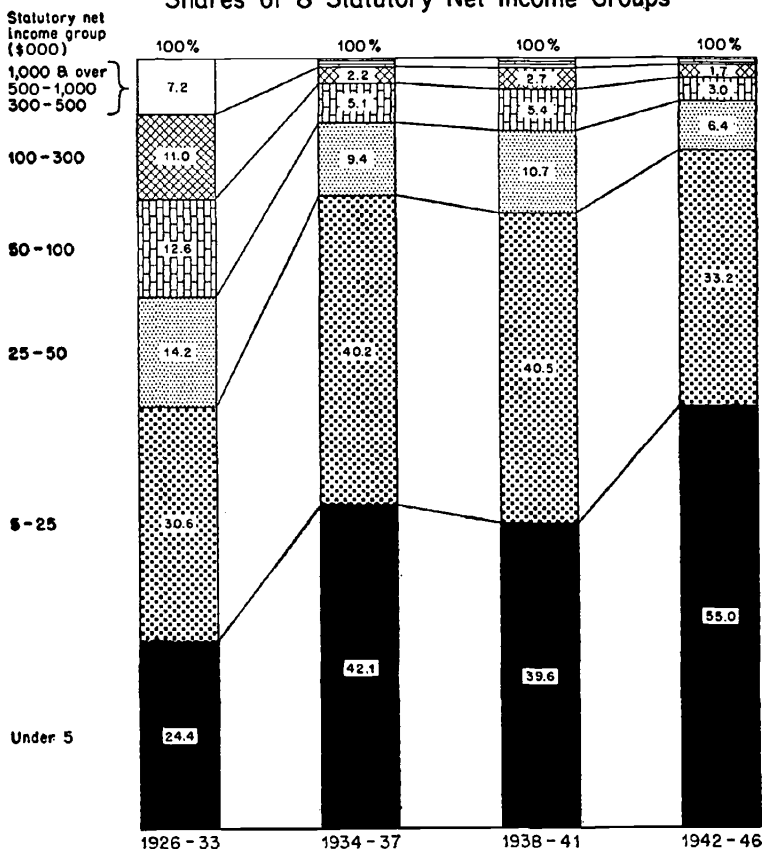


Source: Table 5.

tern is similar in 1934-37 and 1938-40 though the high point was reached at somewhat lower net income levels.

The same type of variation is shown for 1936 when the returns are classified by size of net income excluding net capital gains and losses. The ratio of net loss to other income in 1936 was lowest for individuals with net incomes from 'other' sources under \$5,000, and highest for those with such net incomes of \$5,000-30,000. On the other hand, if we confine our attention to returns with net capital losses, we find that the ratio of net loss to the other income reported on these returns declines as we ascend the income scale to the \$1 million or more group, when the ratio jumps (Table 68).

Chart 14
Net Capital Losses
Shares of 8 Statutory Net Income Groups



Source: Table 3.

Net losses more heavily concentrated than net gains in middle and lower income groups

As indicated above, taxpayers with larger net incomes generally experienced a more favorable ratio, as groups, between net capital gains and losses than those with smaller incomes (Chart 5 shows this for illustrative years, and annual figures 1926-46 are presented in Table 4). This was true in 1936 even when incomes were grouped by size excluding net capital gains and losses (Table 68). Subject to the reservations previously cited with respect to income classifications based on statutory net income, Chart 14 and Table 3 show how the net capital losses of taxpayers with net incomes were distributed among the various income groups in each of the 4 periods of markedly different tax treatment.

Taxpayers with net incomes of less than \$5,000 accounted for 24 percent of the total net capital loss in 1926-33, 42 percent in 1934-37, 40 percent in 1938-41, and 55 percent in 1942-46. Taxpayers with net incomes of \$5,000-50,000 accounted for an additional 45, 50, 51, and 40 percent respectively of the net losses in the 4 periods.

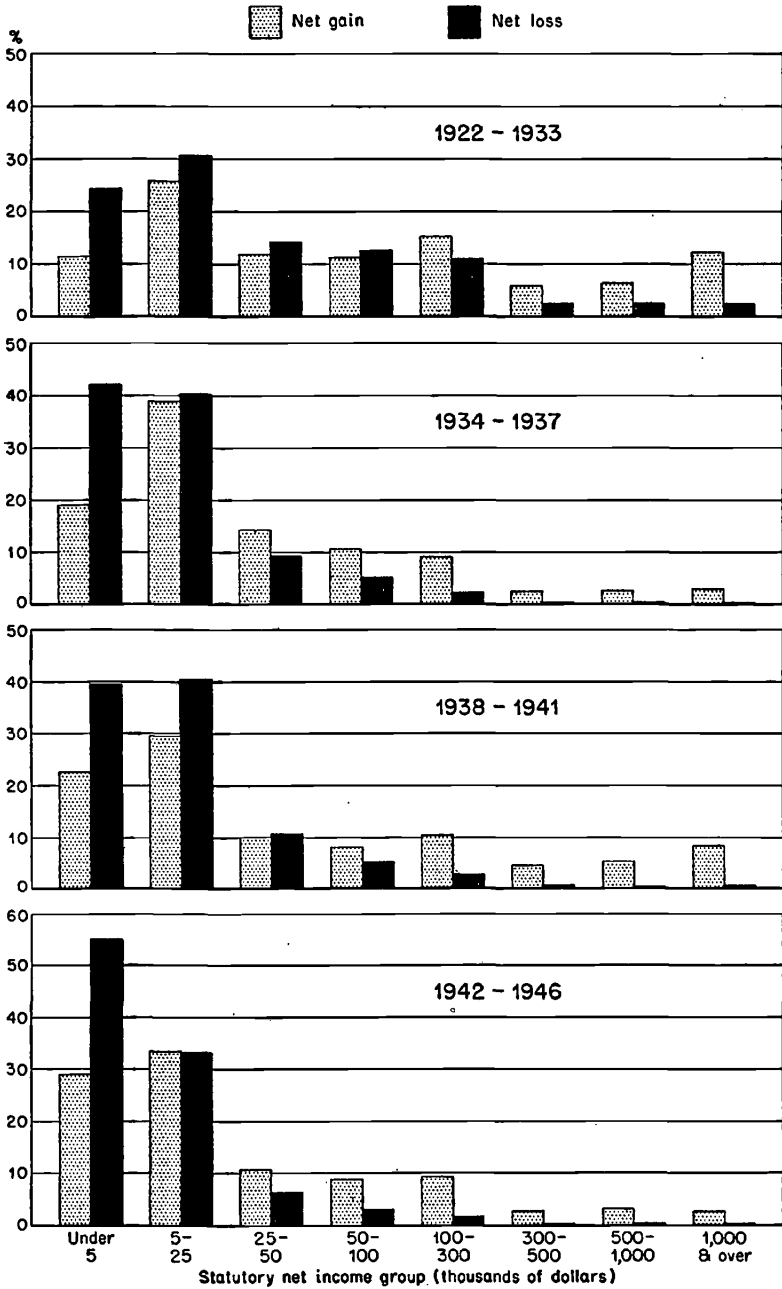
The concentration of net losses in the income groups below \$50,000 is very much more marked than the concentration of net gains (Chart 15 and Table 3). Part, though not all, of the greater concentration occurs because net capital losses, to the extent they were deductible, shifted taxpayers into lower income groups; but this influence upon the income classification was not great because segregated losses (long term net losses of upper income individuals) were not taken into account in determining the income classification in 1924-33, and the deductibility of net losses was severely restricted in the subsequent years.

9 LONG VERSUS SHORT TERM GAINS AND LOSSES

Reasons for differentiating

Except for incidental references, our analysis and discussion so far have not differentiated between gains and losses from sales of assets held only a short period and those held a long time. Such a distinction is of interest for several reasons. First, some persons put them in different economic categories, asserting that short term capital gains are not, properly speaking, capital gains at all, but a species of speculative profit that constitutes a part of ordinary current income. If capital gains and losses are to be given special tax treatment, such persons would confine the special treatment to so-called

Chart 15
Net Capital Gains and Losses
Shares of 8 Statutory Net Income Groups



Source: Table 3.

long term gains and losses, i.e., gains and losses on long-held assets.

Second, the equitable argument commonly advanced in favor of preferentially low tax rates on capital gains and restricted allowances for capital losses is relevant only for transactions extending over more than a year. Based upon the progressive rates at which income taxes are imposed, the argument is that if longer term gains and losses are treated as components of a single year's income, the gains become subject to higher rates and the losses cause larger tax reductions than if merely a *pro rata* part were regarded as emerging each year the asset was held. But this argument is obviously not relevant to gains and losses realized on assets held only 1 year or less.

Third, the effect of alternative tax treatments of short and long term capital gains and losses upon the timing and volume of capital transactions and upon the government's tax revenues has been the subject of considerable discussion and conjecture among legislators and others.

Finally, the various income groups differ with respect to the interval they have characteristically held their assets before realizing on them.

In response to the first 3 factors, the federal income tax statutes, beginning in 1922, have drawn a distinction, though a varying one, between long and short term transactions in capital assets. From 1922 through 1933 net gains from sales of assets held more than 2 years, called long term, were allowed to be segregated from other gains and from ordinary income and taxed at the flat rate of 12½ percent regardless of their amount or the taxpayer's other income, whenever the taxpayer's tax would thereby be reduced.⁶ In 1924-33 net losses from assets held more than 2 years had to be segregated from other losses and from ordinary income for a flat tax credit of 12½ percent if the taxpayer's tax would thereby be increased. From 1934 through 1937, it will be recalled, the statutes divided capital gains and losses into 5 classes according to the interval the assets had been held, and recognized declining proportions of the gain or loss, as the duration of ownership increased, as components of income for tax purposes. In 1938-41 the periods were reduced to three: 18 months or less, 18-24 months, and longer than 24 months. Also, assets subject to allowance for depreciation were excluded

⁶ In 1922 and 1923, however, this privilege was limited by a provision that the total tax, including that on capital gains, be at least 12½ percent of the net income.

from 'capital' assets for tax purposes. In 1942-46 only 2 periods were recognized: 6 months or less for short term, and over 6 months for long term.

Because of these differences in law, only general observations on the differential tax treatment of short and long term gains and losses are possible for 1922-46 as a whole: the several periods must be studied separately for more detailed observations. And for nearly all years the data on net capital losses are less adequate and reliable than those on net gains.⁷

Importance of short term gains and losses has declined relative to long term in recent years

Short term gains and losses appear to have declined markedly in relative importance during 1922-46 as a whole, although good figures are not available for the first half of the period and those for various parts of the remainder are not perfectly comparable.

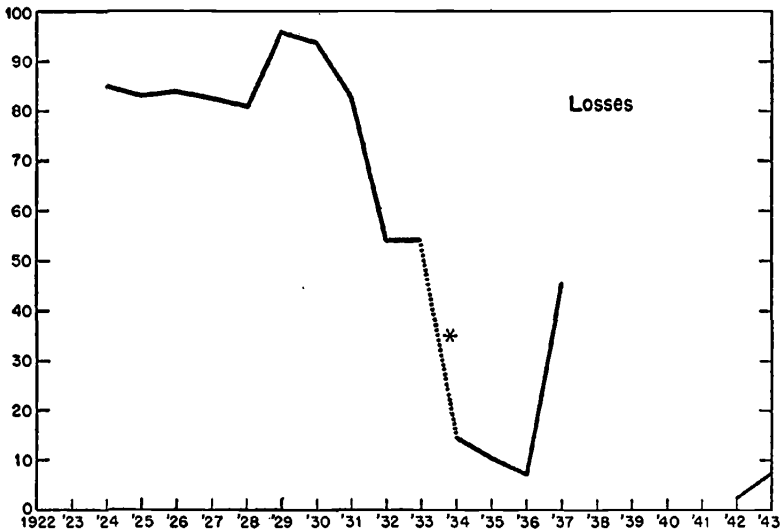
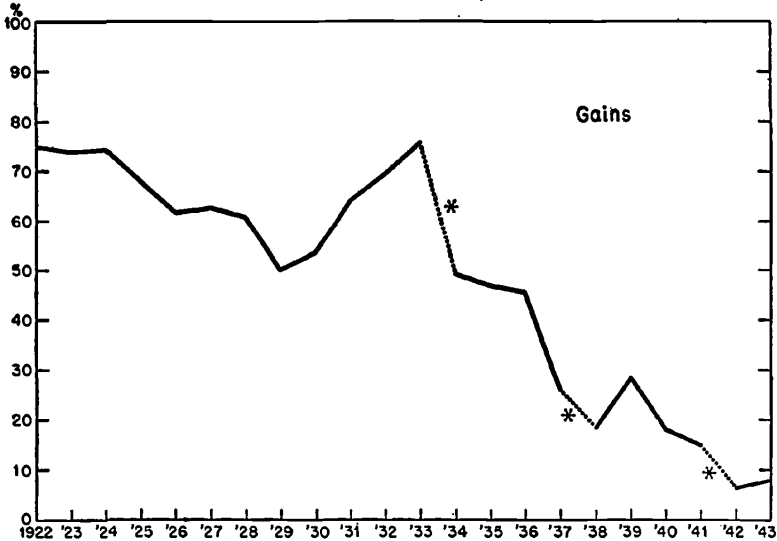
An asset had to be held for 2 years in 1922-33, 18 months in 1938-41, and only 6 months in 1942-46 (as at present) to qualify the gain or loss as long term. Hence, if all other things had remained the same, the proportions that short term gains and losses constituted of the total would have fallen over the period 1922-46 as a whole merely by reason of the changing statutory definitions. But the figures within periods of similar tax treatment suggest that the decline was due to other factors as well.

From 1922 through 1933 long term gains, on assets held more than 2 years, were reported as such only by taxpayers who found it more profitable to exercise the option to subject these gains to a flat tax of 12½ percent than to treat them, together with short term gains, as ordinary income. As few taxpayers with incomes less than a figure that ranged from about \$16,000 to \$32,000 a year found it

⁷ The amounts of net losses other than those segregated for tax credit at 12½ percent have not been published for years before 1926 and the published figures are incomplete for 1932 and 1933. Our estimates of net losses for 1917-25 and for 1932 and 1933, based in part on sample data, are less reliable than the tabulated data available for other years. *Statistics of Income* figures for 1926-28 understate unsegregated capital losses because many taxpayers listed them under 'general deductions', and not until 1929 did the Bureau of Internal Revenue begin to include capital losses so listed in its tabulations of capital losses. Segregated long term net losses in 1924-33, like segregated net gains, do not cover all transactions in assets held more than 2 years because most taxpayers with net incomes of less than about \$16,000-32,000, since they were not required to segregate them, treated them as short term losses for income tax purposes.

profitable, our figures for aggregate short term gains in 1922-33 include the long term gains of all except the higher income groups. The percentages these impure figures constituted of the total net

Chart 16
 Short Term Net Capital Gains and Losses as Percentages of Total
 Individuals with Net Incomes, 1922-1943



* Change in statute.
 Source: Table 13.

gains of individuals reporting net incomes tended to decline during the 'twenties, then rose in the first 4 years of the 'thirties (Chart 16 and Table 13).

We have good figures for gains on assets held 2 years or less during 1934-37, and 18 months or less during 1938-41 because *all* taxpayers were required to report their gains according to the length of time the asset had been held. The short term gains of individuals with net incomes declined from 49 percent of total gains in 1934 to 26 percent in 1937. In 1941 net gains on assets held 18 months or less had shrunk to 15 percent of the total. In 1943 net gains from assets held 6 months or less were only 8.0 percent of total net capital gains (Chart 16 and Table 13).

The figures for capital losses, as previously noted, are less complete and satisfactory. No figures are available for short term net losses in 1922 and 1923 because long and short term losses were treated alike by the law; and no figures are available for short term net losses for 1938-41. The amounts and proportions of short term losses increased in 1929 and 1930 when the stock market was sharply declining, shrank very substantially in 1932 and 1933 when short term trading was on a much reduced scale, and again declined markedly during the upturn in the stock market in 1934-36 when short term losses amounted to only 7-14 percent of total net losses, while short term net gains accounted for almost half of total net gains. With the break in the stock market in 1937 the amount and proportion of short term losses again rose sharply (Chart 16 and Table 13).

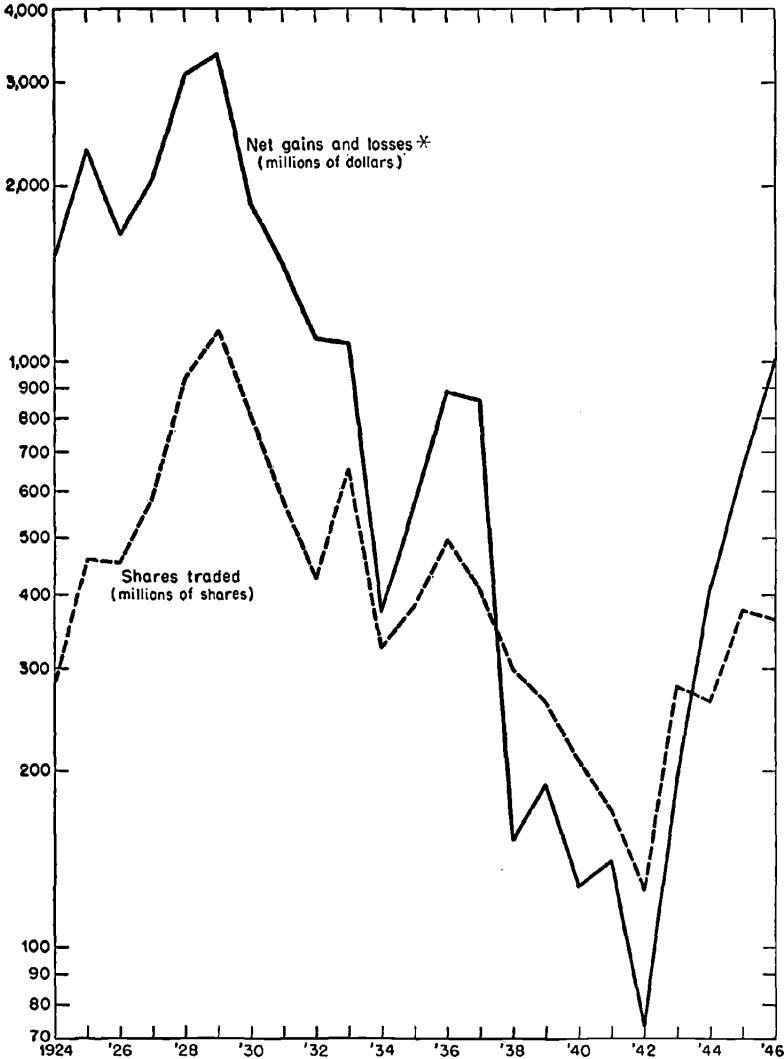
Short term gains and losses closely reflect stock market fluctuations

The decline in the absolute and relative importance of short term gains and losses in most recent years has been associated in general with the diminished trading in the stock market (Chart 17 and Table 15), and is probably subject to quick reversal if any combination of factors should stimulate an expansion of stock market activity. As long as a holding period of only 6 months and a day is sufficient to classify a capital asset as long term, however, many gains and losses that would have been regarded as short term under the statutes of 1922-41 will be classified as long term.

We previously found, as was to be expected, a considerable though imperfect correspondence between fluctuations in aggregate annual realized net capital gains and losses and in prices on the New York Stock Exchange. The relation is closer for short term gains and

losses alone (Chart 18). The correspondence in 1939-41, in particular, was more pronounced than for total net gains. In general, the

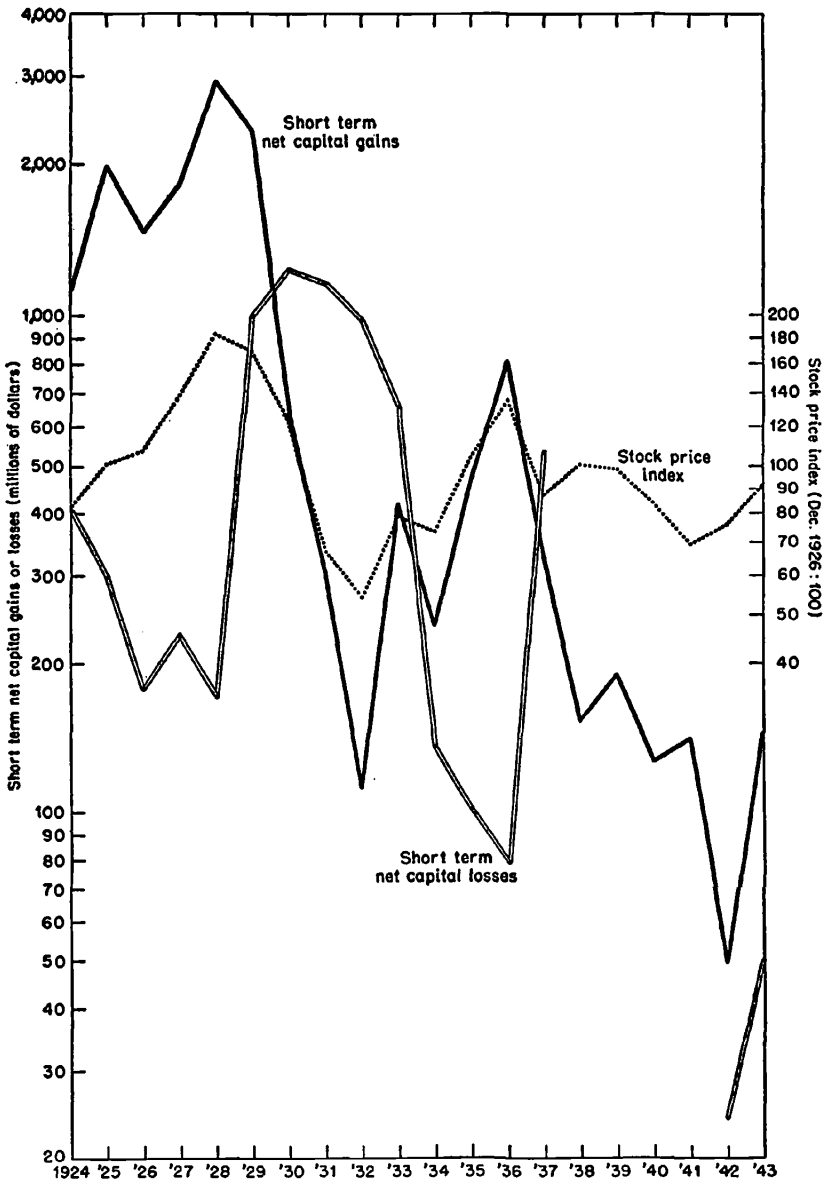
Chart 17
Shares Traded, New York Stock Exchange, and
Arithmetic Sum of Short Term Net Capital Gains and Losses
1924 - 1946



* Short term loss not included 1938-41 because data are unavailable.
Source: Table 15.

Ratio scale

Chart 18
Stock Price Index and Short Term Net Capital Gains and Losses
 1924 - 1943



Source: Table 8.

Ratio scales

movements of net losses were the reverse of those of gains. The steep rise in losses recorded in 1929 is somewhat exaggerated because capital losses that were improperly classified were omitted from the tabulations in the preceding 3 years but were included beginning in 1929 (see note 7).

The securities and certain commodity markets are the only ones in which large short term transactions in capital assets are regularly feasible. When short term transactions are undertaken in real estate, they are commonly executed mainly by individuals and firms regularly engaged in the business, so that the resulting gains and losses are accounted components of current income rather than capital gains and losses.

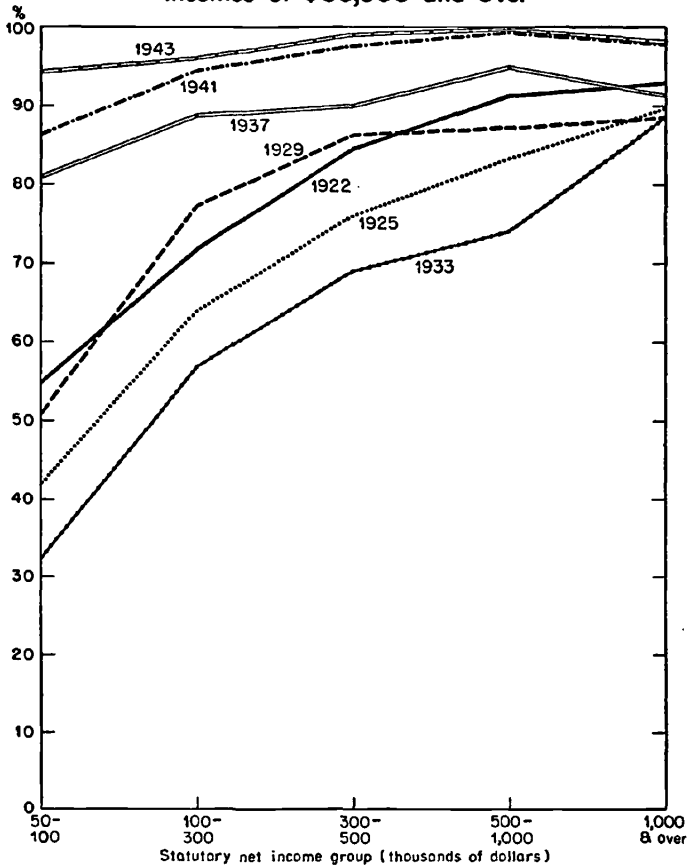
Long term gains account for an increasing proportion of total net gains as we ascend the income scale

With remarkable consistency long term gains account for an increasing proportion of the total as we go up the income scale (Chart 19 and Table 13). In 1924, for example, they constituted 54 percent of the total net gains of taxpayers with net incomes of \$50,000-100,000, 75 percent in the \$100,000-300,000 group, 87 percent in the \$300,000-500,000 group, 94 percent in the \$500,000-1,000,000 group, and 95 percent for those with \$1 million or more.

Tabulations for income groups below \$50,000 are not available before 1933 because these taxpayers did not find it profitable under the varying provisions pertaining to personal exemptions, credits, and rates consistently to segregate their long from their short term gains in their income tax returns. The 1933 figures, however, in part estimated by us on the basis of sample data, show the same pattern for these income groups (Table 10). Long term net gains accounted for 13 percent of the total net gains of taxpayers with net incomes under \$5,000, 22 percent for those in the \$5,000-25,000 group, and 27 percent for those in the \$25,000-50,000 group. The detailed data available for 1934-46, while reflecting a general diminution in the relative importance of short term gains, likewise display this pattern (Table 13). In 1934-37, for example, long term net gains accounted for 55 percent of the total net gains of taxpayers with net incomes under \$5,000, 56 percent for those with incomes of \$25,000-50,000, and 80 percent for those with incomes of \$300,000-500,000.

A special illustration of the same general tendency is supplied by the figures for 1934-37 showing the importance of assets held more

Chart 19
 Long Term Net Capital Gains as Percentages of Total
 by Statutory Net Income Groups
 Incomes of \$50,000 and Over



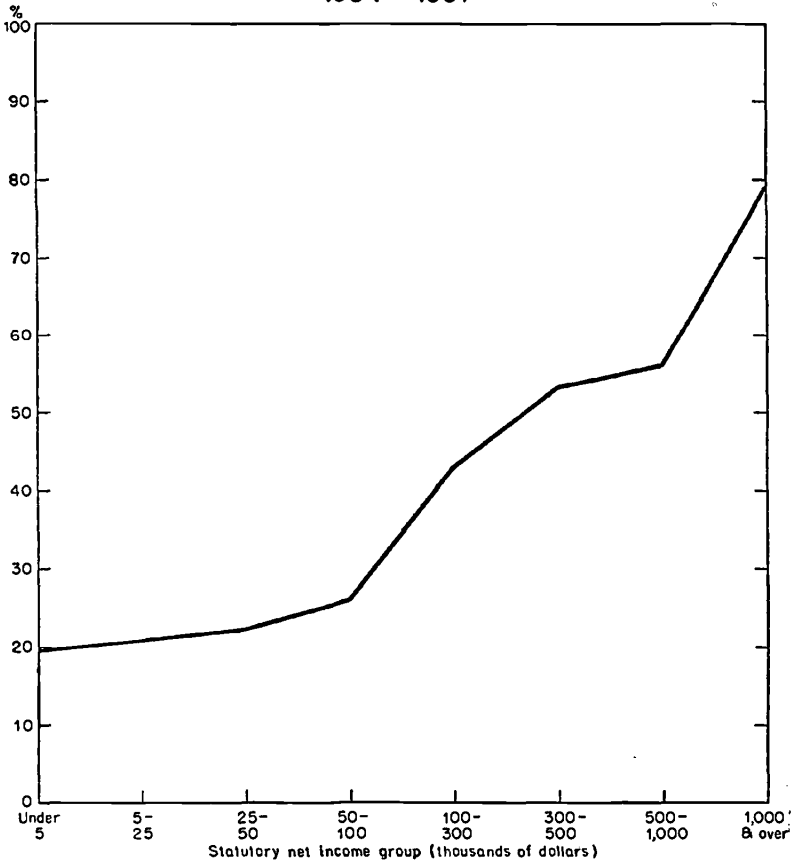
Source: Table 13.

than 10 years as a source of net capital gains in the different income groups (Chart 20 and Table 19). Assets held more than 10 years accounted for about a fifth of the net gains of taxpayers with net incomes under \$25,000, for about a quarter of those in the \$25,000-100,000 group, for about half of those in the \$100,000-1,000,000 group, and for almost 80 percent of those in the \$1 million or more group.

Short term losses constitute a large fraction of the total losses of the upper income groups

While long term net gains quite regularly constitute an increasing

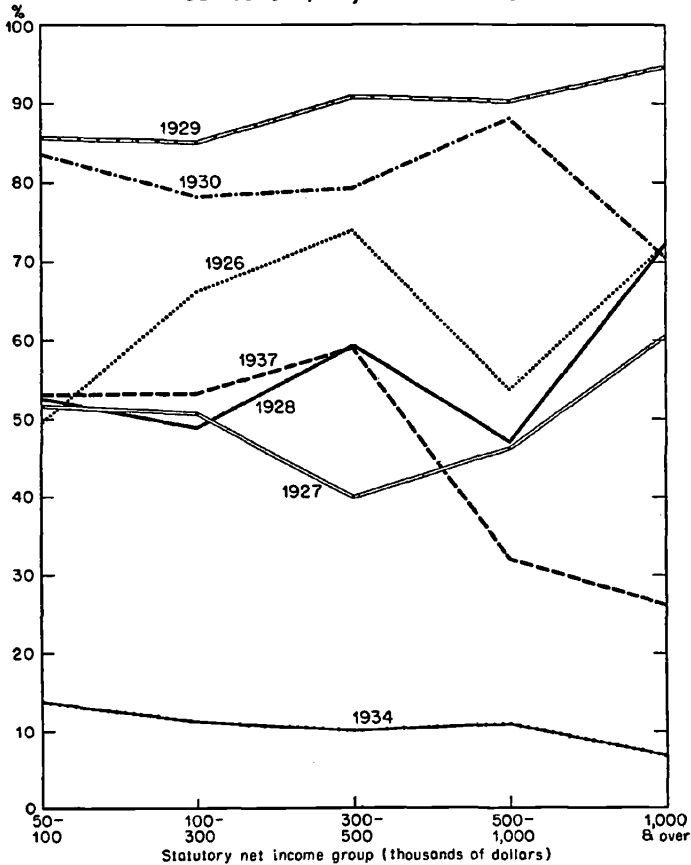
Chart 20
 Net Capital Gains from Assets Held more than 10 Years
 as Percentages of Total by Statutory Net Income Groups
 1934 - 1937



Source: Table 19.

fraction of total gains as we ascend the income scale, and short term gains play a diminishing role, the like cannot be said of losses. Short term losses often account for a large and sometimes a rising fraction of total losses as we move up the income scale (Chart 21 and Table 13). One possible explanation is that taxpayers with large incomes tend to be no more successful in their short term speculations than those with smaller incomes, though distinctly more successful in their longer term ventures. Another is that they tend to wind up their losing ventures quickly, throwing a large part of their losses into the short term category, while they hold their profitable invest-

Chart 21
Short Term Net Capital Losses as Percentages of Total
by Statutory Net Income Groups
Incomes of \$50,000 and Over



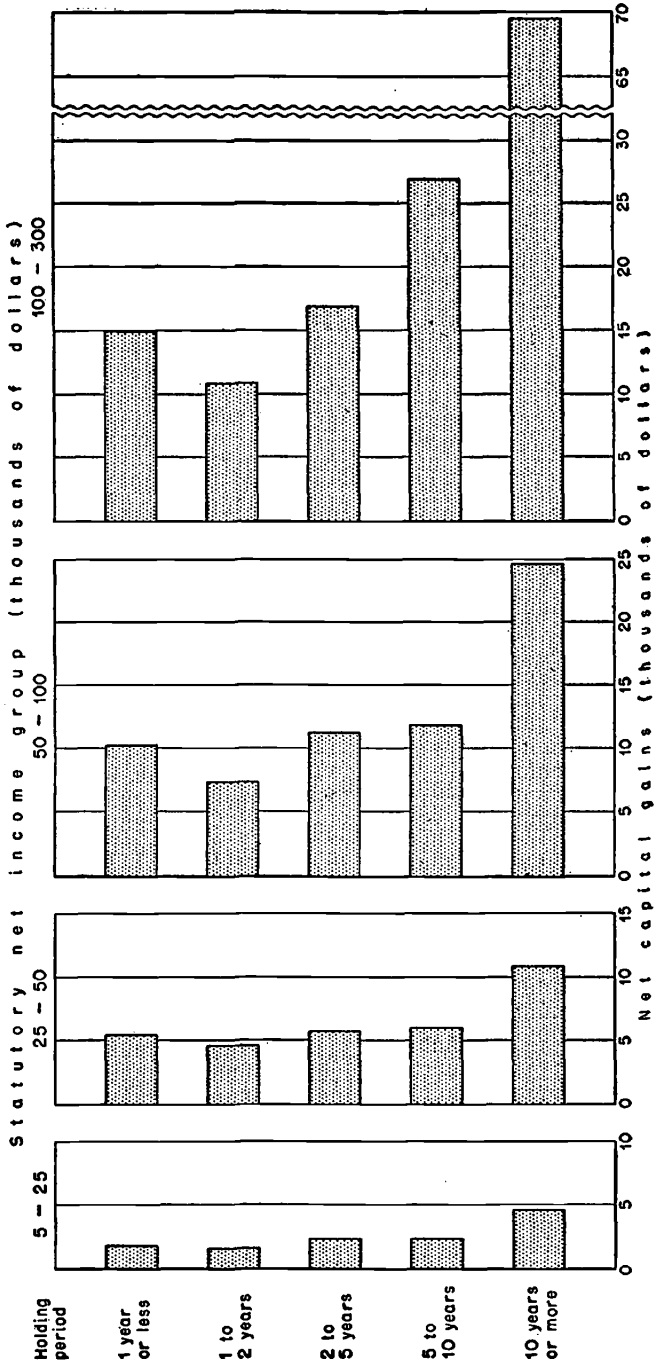
Source: Table 13.

ments longer. In other words, they may follow the old adage of the stock market: 'Cut your losses short but let your profits run.' By allowing short term losses to be offset in full against income of all kinds and limiting the tax rate on long term gains to $12\frac{1}{2}$ percent the tax laws offered a distinct incentive to follow this policy in 1922-31.

Average gains larger the longer the asset is held and the larger the net income

For both long and short term transactions in 1934-37 average gains were larger the longer the asset was held and the larger the net

Chart 22
Average Net Capital Gain by Holding Periods and Statutory Net Income Groups
 1934 - 1937



Source: Table 38.

income, but differences according to income level were decidedly wider on long term transactions (Chart 22 and Table 38). Taxpayers with net incomes of \$5,000-25,000 who reported net gains from assets held 1 year or less had an average such gain of \$1,800; those with net incomes of \$25,000-50,000, an average of \$5,400; and those with net incomes of \$500,000-1,000,000, an average of \$46,000. For the same income groups, the average net gains from assets held longer than 10 years were \$4,600, \$10,800, and \$315,600 respectively. The pattern of average net losses classified by both income group and period of holding is roughly similar.

Viewing these averages in another way, we may say that at every income level, longer term net gains and losses were larger on the average than shorter term, and that the difference between the results of shorter and longer term transactions widened as the income level rose. When the returns for 1936 are grouped by size of net income excluding capital gains and losses, the differences between income levels are less pronounced though still wide (Table 80).

Gains and losses as percentages of original cost varied directly with holding period in sample of returns for 1930 and 1932

The preceding few paragraphs have indicated that net gains and losses from longer term transactions have averaged larger than those from shorter term transactions. Sample data for 1930 and 1932 covering transactions in stocks grouped by detailed holding periods indicate that in at least these 2 years the larger gains and losses also represented larger proportions of the original cost of the assets.⁸

With qualifications that will readily occur to the reader, these data support the maxim: 'Cut your losses short but let your profits run'. The ratio of gross gains to the estimated original cost of the stocks rises as the holding period lengthens (Table 54). In 1930 gross gains from securities held 1 month amounted to 8 percent of the cost; for the 5 month holding period, 28 percent; for the 24-36 month period, 50 percent; and for securities held 120 months or longer, 110 percent. The ratios for sales with losses were also substantially higher in 1930 for long than for short holding periods.

⁸ These data, provided by the taxpayer on the back of his income tax return and not ordinarily tabulated or published in *Statistics of Income*, were assembled in an unpublished study of capital gains and losses by the Bureau of Internal Revenue from samples of individual income tax returns. The original cost was approximated by deducting the gross gain or adding the gross loss to gross receipts. This procedure ignores brokerage fees and similar items of expense, and assumes that the asset was not acquired before 1913 or by gift or inheritance.

In 1932 they rose from 8 percent for sales of stock held less than 1 month to 73 percent for the 36-48 month holding period, then declined for longer periods. The relative size of the ratios in the several periods reflects, of course, the level of stock prices in 1930 and 1932 as compared with the level at the time of purchase.

10 RELATIVE IMPORTANCE OF SECURITIES, REAL ESTATE, AND OTHER ASSETS AS SOURCES OF CAPITAL GAINS AND LOSSES

Common stocks the chief source of capital gains and losses

The great bulk of capital gains and losses is derived from transactions in securities, mainly from the common stocks of business corporations. In 1936, the only year for which comprehensive data are available, 79 percent of the total net gain and 68 percent of the total net loss were reported as derived from stocks and bonds (Table 69). The actual proportions were doubtless larger because a substantial fraction of the total gain and loss, approximating 15 percent in New York State, was attributed to 'unclassified assets'. Of all taxpayers reporting transactions in capital assets 73 percent reported sales of securities. While the figures do not distinguish between common and preferred stocks, the preponderance of the former is indicated by the much larger amounts outstanding and by their greater activity in the investment and speculative markets.

For New York, Pennsylvania, and Illinois, figures have been tabulated showing the relative importance of 9 types of assets as sources of capital gains and losses in 1936 (Table 74). In New York 82 percent of net gains and 74 percent of net losses were realized from sales of securities (an additional 15 percent of the gains and 14 percent of the losses were unclassified). Real estate and improvements were largest among the other assets but accounted for less than 2 percent of total gains and 9 percent of losses. In Illinois real estate was somewhat more important, especially as a source of loss; otherwise, the distribution in both Illinois and Pennsylvania was similar to that in New York.

Real estate losses exceed gains in 1936

If we approximate original cost by deducting the net gain from, or adding the net loss to, the gross receipts from sales of assets,⁹ we find that the aggregate excess of gains over losses from transactions in securities reported on federal income tax returns from New York

⁹ We thereby ignore brokers' fees and similar expenses, as well as any adjustments that might be required to make more accurate allowance for depreciation, cost of improvements, etc.

State in 1936 amounted to 3 percent of the estimated cost, whereas all other assets showed a loss amounting to 10 percent of their aggregate estimated cost (Table 75). Stocks were the biggest source of gain and loss for all income groups (Table 76). The highest loss ratios were for mortgages and loans, 31 percent, and for real estate and improvements, 18 percent. Real estate constituted a bigger source of loss than of gain for every income group, with one exception, as well as for all income groups combined.

Some reasons why real estate is a smaller direct source of capital gains and losses than it is a constituent of total private wealth

The subordinate importance of real estate as a source of capital gains and losses is in sharp contrast to its outstanding position as a constituent of total private wealth. The Federal Trade Commission estimated that taxable real estate constituted about 53 percent of the total wealth of the United States in 1922; the National Industrial Conference Board placed the figure at 60 percent in 1938.¹⁰ The values of the principal classes of real estate in the United States in 1930 have been estimated to be (in billions of dollars): residential nonfarm, 122.6; commercial, 57.0; farm, 47.9; industrial, 39.2; tax-exempt, 34.6; all other, 12.9; totaling, 314.2.¹¹ Price movements in real estate, moreover, are often substantial, giving rise to large possibilities of capital gains and losses. The value of American farm land nearly tripled between 1900 and 1920, rising from \$24 billion to \$66 billion. Thereafter it declined, falling \$17.1 billion by 1925 and \$14.5 billion more by 1940.¹² Similarly, the value of nonfarm real estate, after large advances, is estimated to have declined from \$266 billion in 1930 to \$172 billion in 1934.¹³

One reason for the disproportionately small role of real estate as a direct source of capital gains and losses reported on individual income tax returns is that the title to much of the country's more valuable real estate, e.g., the land and buildings that constitute much of the fixed plant of large industrial and merchandising enterprises and the more valuable office and store buildings and apartment houses in urban areas, is held by business corporations, not indi-

¹⁰ *National Wealth and Income*, 69th Cong., 1st Sess., Senate Document 126, pp. 28, 30, and 34; *Economic Almanac, 1942-43*, p. 375.

¹¹ David L. Wickens, *Residential Real Estate* (NBER, 1941), pp. 2 and 3.

¹² *Census of Agriculture, 1940* (Department of Agriculture).

¹³ Wickens, *op. cit.*, pp. 2 and 3. Estimates of the aggregate value of nonfarm land for Census years 1880-1922 are presented in Kuznets, *National Product since 1869* (NBER, 1946), p. 201.

viduals. When corporations sell real estate at a profit, the capital gains do not appear as such in the incomes of the individual stockholders. If and when the gains are distributed, they reach the stockholder as dividends; if retained by the corporation, they may enhance the market value of the stock and lead to capital gains from securities.

Nor are capital gains and losses from real estate fully reported as such by corporations. Many transactions that would result in statutory capital gains or losses if undertaken by the individual stockholders give rise to ordinary income when undertaken by a corporation formed by these stockholders to conduct their real estate operations: the corporation becomes a real estate dealer, not an investor entitled to special tax treatment. The statutory provisions and judicial decisions holding that gains and losses shall not be recognized for tax purposes in connection with various types of corporate mergers, acquisitions, and exchanges have also reduced the recognized amounts of capital gains and losses from real estate for both corporations and individuals.

Apart from the influence of legal form, real property in fact probably changes hands much less frequently than securities; consequently, a larger proportion of the appreciation and depreciation in value remains unrealized in a legal sense by the owners. Various factors make real estate a slow-moving asset as a rule. It is immobile. It must commonly be sold in relatively large units, in contrast to the remarkable divisibility of wealth in the form of securities. Each parcel has a unique location. An elaborate legal procedure must be gone through to assure a clear title. The real property owned by industrial and merchandising enterprises rarely comes on the market because it constitutes an important part of their fixed plants and is not commonly sold separately from the business itself. Some \$65 billion, or more than half of the total value of nonfarm residential real estate in 1930, consisted of the value of houses occupied by their owners. An impulse to sell to realize a profit or avoid a loss is subject to restraining considerations of family and neighborhood ties, children's playmates and schools, habit, sentiment, etc., which are present far less commonly in connection with securities. The case is similiar with farms, most of which are occupied by their owners. An impulse to sell is often overcome by the thought that a home as well as an investment and a means of livelihood will be given up.

Nevertheless, though shifts in the ownership of real estate are

probably less frequent than in securities, they are more frequent than the preceding considerations might suggest. The mobility of individuals and business enterprises in the United States doubtless counteracts these influences to some extent. A study of the duration of ownership of real property in New York State, made in 1930 under the direction of Robert M. Haig for the New York State Commission for the Revision of the Tax Laws, indicated that 56.5 percent of the urban properties comprising the sample had been sold at least once in the preceding 11 years, and 72.5 percent, in the preceding 21 years.¹⁴ The turnover was slower in rural areas, 35.8 percent of the properties in the sample having been sold in the preceding 11 years, and 54.8 percent in the preceding 21 years. For all areas together, from half to three-fourths of the properties in the sample had been acquired by their 1930 owners within the preceding 21 years.

Considerable amounts of capital gains and losses from real estate go unreported because they are embodied in transfers of title at death instead of being realized through sale.

In a survey we made of the length of ownership of real properties in Manhattan by 41 individuals and estates known for the continuity of their ownership, including such famous family names as Astor, Adrian, Beekman, Bradley, Gerry, Goelet, Rhineland, Rockefeller, Ruppert, and Stuyvesant, we found that one property had remained unsold for 97 years, another for 136 years, and 43 others for periods so long that the deeds did not bear any date. Of the 922 properties, comprising all those in Manhattan held in the names of

LENGTH OF OWNERSHIP OF
REAL ESTATE IN MANHATTAN BY 41 WEALTHY INDIVIDUALS AND ESTATES

YEARS HELD ON 12/31/1942	NUMBER OF PROPERTIES	PERCENTAGE OF TOTAL
10 or less	204	22.1
10 to 20	131	14.2
20 to 30	72	7.8
30 to 40	257	27.9
Over 40	258	28.0
Total	922	100.0

The last date of sale of all the real properties in Manhattan in the names of the 41 individuals and estates at the end of 1942 was obtained from the *Real Estate Directory of Manhattan*. Properties of the 41 owners outside Manhattan or legal title to which was vested in other names were not included.

¹⁴ Edwin H. Spengler, *Turnover of Title to Real Property in New York*, New York State Commission for the Revision of Tax Laws, 1932.

these 41 individuals and estates at the end of 1942, fewer than half had been held less than 30 years.

Because of the foregoing factors, the reported amounts of capital gains and losses realized from real estate doubtless understate the power of increases and decreases in the value of real property to enrich or impoverish individuals.

Capital gains and losses from real estate are unlikely to cancel for most investors because diversification of risks is difficult

A considerable degree of diversification of risks is possible by investment in the securities of large corporations because such enterprises commonly do business on a nationwide scale and because the investment of even a moderate sum can readily be distributed among several corporations. Real estate is much different in these respects. The practicable unit of investment is relatively large: not more than 1 or 2 improved properties can usually be purchased for \$15,000, for example. The properties chosen will of necessity be in only 1 or 2 areas and their value will be highly responsive to purely local developments. For these reasons few investors can widely diversify their risks. Hence, in the case of real estate even more than in that of securities, varying excesses of gains on the part of some investors and of losses on the part of others are more likely than a canceling of gains and losses.

The significance of this probability for tax purposes is that equal treatment of capital gains and losses may lead to wide disparities in the tax treatment of different individuals. Equal limitations on the proportions of gains and losses recognized for income tax, for example, will reduce the allowance for net losses for numerous investors who will get little or no benefit from the corresponding reduction in the taxation of capital gains. In short, the effect of such equal treatment is to accentuate both the gains of the winners and the losses of the losers.

Some examples of highly divergent movements in urban land values, taken from a survey we made of tax assessment values in Cleveland and in the borough of Manhattan in New York City, are shown as noted previously in Chart 1 and Table 91.¹⁵

¹⁵ For Manhattan we obtained the 'unit values' of the land in the blocks in several areas, including many blocks on the four principal avenues, Fifth, Sixth, Seventh, and Eighth, from land value maps maintained by the Surveyor's Bureau of New York City's Tax Department. The 'unit value' in Manhattan, defined as the value per front foot of a lot 100 feet deep of "normal size and on a level with the grade of the street," is computed by capitalizing at

Cleveland

The tax assessment value of the land in Cuyahoga County, which contains the City of Cleveland, more than quadrupled between 1910 and 1924, rising from \$295 million to \$1,256 million. An ensuing decline, rapid at first and then gradual, left the total at \$520 million in 1942, or 41 percent of the 1924 value and 176 percent of the 1910 value. Those who died or sold out before 1924 participated only in the upswing; those who bought after 1924, only in the downswing. Five lots, all on or adjacent to Euclid Avenue, illustrate the divergent experience of individual ground sites. Between 1910 and 1924 these 5 lots rose, respectively, 152, 569, 300, 700, and 33 percent in value. (Their locations were, respectively, Euclid Avenue near Third, 40th, 65th, and 105th Streets, and East 55th Street near Euclid.) They declined between 1924 and 1942 respectively 21, 86, 87, 45, and 73 percent. Three lots were worth less in 1942 than in 1910, while 2 remained far above their 1910 values (Chart 1 and Table 91).

6 percent the estimated income the site would yield if put to its highest economic use under current conditions. From it, the worth of the lots in the block is derived, after allowances for differences in shape, depth, and position from the standard unit. Corner lots and those next to corners, because of their greater accessibility and prominence, are appraised at higher values than those nearer the middle.

For Cleveland we obtained from John A. Zangerle, Auditor of Cuyahoga County, the assessed values of standard lots with 50 feet frontage and 150 feet depth at widely separated points on or near Cleveland's main thoroughfare, except that the figures supplied for one lot, that on East 55th Street near Euclid, were the actual sales prices.

Tax assessment values are not accurate measures of market values; but they are useful for our present purposes because we are primarily interested in the *relative* changes in the values of different sites, and in wide swings in value. Estimated in terms of the representative or unit lot, the assessor's figure for a particular property may depart substantially from its market value at a given time. Moreover, assessment values tend to lag behind movements in market values in both directions, but particularly on the downside, when pressure against reduced assessments is exerted by the debt limit of a city, which is usually based on the total assessed valuation, and by the desire to avoid an increase in the nominal tax rate. Different assessing areas assess property at different fractions of the estimated market value. These deficiencies are serious when assessed values are used for close measures of market values, but are much less so when used, as is done here, as measures of *relative* movements in the market values of different sites and as rough measures of very wide swings in market values.

Manhattan

The assessed value of the land in Manhattan increased from \$3 billion in 1920 to a peak of \$5.5 billion in 1931, then declined to \$3.7 billion in 1942.¹⁶ Both the \$2.5 billion appreciation in the earlier period and the \$1.8 billion depreciation in the later created opportunities for large capital gains and losses, but here too the movements of individual properties diverged markedly from the average and from one another.

In contrast to the wide movement of the assessed value of Manhattan land as a whole, relatively little change took place in parts of the financial district where land values have been highest. The block occupied by the Equitable Building, between Pine and Cedar Streets, was assessed on the Broadway side at \$18,000 a front foot in 1909, \$24,000 in 1929, and \$21,000 in 1942.

On the other hand, the assessed value on Seventh Avenue near 34th Street (block number 786) was \$2,400 per front foot in 1909, \$3,400 in 1920-22, \$5,000 in 1924, \$8,400 in 1929, \$9,400 in 1930-32, and \$7,800 in 1940-42.

In the neighborhood of Grand Central Station, on 42nd Street from Fifth to Park Avenues, the unit values ranged from \$4,200 to \$5,000 per front foot in 1909, rose to \$8,000 per front foot by 1913, and to peak values ranging from \$19,700 to \$22,000 a front foot in 1930, then declined to \$16,000-18,000 per front foot by 1942.

We obtained from the assessment records the unit values between 1909 and 1942 of every other block on the east side of Fifth Avenue from Washington Square to 74th Street. The assessed values were lower in 1942 than in 1909 for some parts of the Avenue, higher for others. But on Seventh Avenue all the blocks were substantially higher in 1942 than in 1909.

In summary, in 1909-31 changes in the assessed value of units in the Manhattan blocks included in Chart 1 and Table 91 ranged from a 49 percent decline to a 633 percent increase; in 1931-42 from an 8 percent increase to a 51 percent decrease; and for the entire period 1909-42, from a net decline of 75 percent to a net increase of 467 percent.

¹⁶ Annual Reports of the Tax Department and Tax Commission, New York City.

11 SPECIAL STUDIES OF CONTINUING GROUPS OF INDIVIDUALS WITH LARGE INCOMES

Aggregate figures not necessarily representative of particular individuals or groups

From the statistical materials so far discussed, presenting various aspects of gain and loss realization for aggregates of individuals filing income tax returns during the 30 years 1917-46, we cannot follow the experience of any one individual or of any small group and determine whether the over-all picture hides significant diversities in the experience of different groups of taxpayers. Have gains and losses canceled to a significantly lesser degree for certain groups than for income taxpayers as a whole? Our analysis of the distribution of gains and losses by income groups is deficient as a source of information in this respect because some of the individuals comprising each income group in one year shifted into other groups in other years.

For this reason it is useful and interesting to supplement the foregoing discussion by analyzing a small body of materials pertaining to the realized gains and losses of continuing groups of individuals for a period of years. In its *Source Book of Statistics of Income* the Bureau of Internal Revenue has a series of tabulations showing the sources of income and the deduction items in 1917-36 for the 75 taxpayers who reported net incomes of \$1 million or more in 1924. Data for some of the individuals are incomplete; for 45 data are complete from 1917 through 1933.

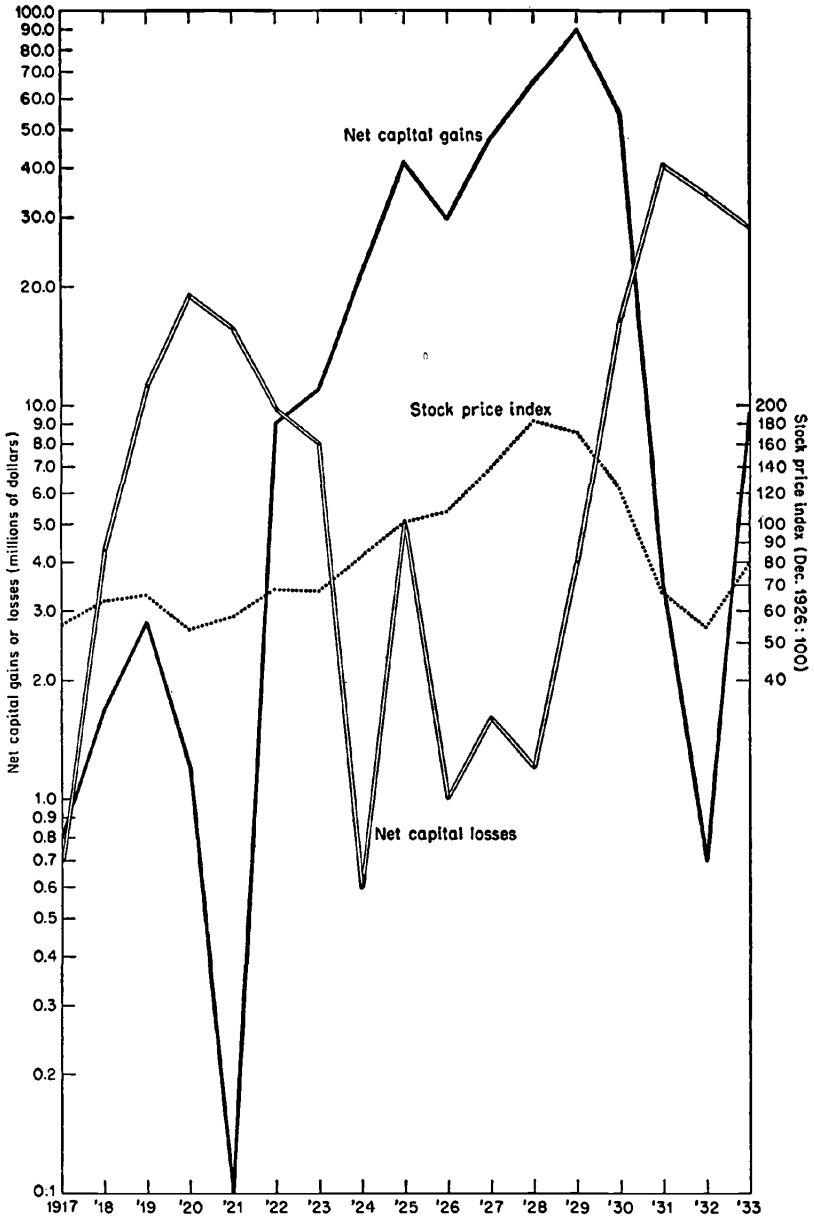
45 individuals with 1924 net incomes of \$1 million or more showed continuing high concentration in upper income groups

The first thing to be noted about this group of individuals is that the net incomes of the great majority remained at fairly high levels throughout the period. Not more than 6 of the 45 reported net incomes under \$50,000 or net deficits in any year between 1917 and 1930, and well over half reported incomes in excess of \$100,000 in the worst year of the period, 1932 (Table 83).

Annual fluctuations in their gains and losses more accentuated than in those of all taxpayers

The relation between the net gains and losses of these individuals as a group 1922-33 and the movement of stock prices (Chart 23 and Table 85) is similar in a general way to that for all taxpayers but the annual fluctuations are much more marked. Whereas the net gains of all individuals with net incomes were about 30 times as large in 1928 and 1929 as in 1932, those for the 45 individuals were more than 100 times as great.

Chart 23
 45 Persons with Million Dollar and Over Incomes in 1924
 Net Capital Gains and Losses and Stock Price Index
 1917 - 1933



Source: Table 85.

Ratio scales

Their transactions in capital assets resulted in a large net gain for the group as a whole but in highly divergent experiences for the individual members

Capital gains and losses did not cancel in the long run for this group of taxpayers. Of the 45 individuals 27 enjoyed an aggregate excess of net gains over net losses in the 17 years of \$253 million, or 18 percent of their total income (before negative and deduction items). (The excess of net gains may be somewhat overstated because short term net losses for 1932 and 1933, which were not allowed as deduction items by the statutes, are not taken into account.) The other 18 individuals reported an aggregate excess of net losses over net gains of \$66 million, or about 10 percent of their total income. The 27 taxpayers with an over-all profit reported annual net gains aggregating four times as much as the sum of the net losses they sustained in their loss years (Table 84).

The 45 individuals differed greatly with respect to the importance of capital transactions as sources of income and deductions. Three reported net gains amounting to less than 5 percent of their total income in the 17 years, and may actually have realized a net loss on balance if account were taken of the short term losses in 1932 and 1933 that were not recognized by the statutes. Another 13 reported net gains ranging from 5 to 25 percent of their total incomes; 7, net gains of 25-50 percent, and 4, net gains amounting to more than 50 percent of their total incomes (before negative and deduction items).

The differences among those in the group that reported an over-all net loss were not as wide. Six reported net losses amounting to less than 5 percent of their total income, 7, net losses of 5-15 percent, and 5, net losses of 15-25 percent. All realized net gains in some years. As a group, the 18 who reported an over-all net loss had realized net gains amounting to somewhat less than half of their aggregate annual net losses.

Second sample of high income taxpayers shows characteristics in 1929, 1932, and 1937 similar to those of the 1924 group

A second set of sample data is available in the *Source Book of Statistics of Income* for 1929, 1932, and 1937 for the 141 persons who reported the highest net incomes in 1929 and whose returns for the other 2 years were available. Virtually all reported capital transactions in each of the 3 years (Table 86). In 1929, 3 times as many reported net gains as reported net losses; in 1932 virtually all reported net losses; and in 1937 the numbers were equal. The loss

data for 1932 are incomplete because short term net loss from sales of securities was disallowed by statute as a deduction item.

The net gains realized by this group in 1937 were almost 3 times as large as the net losses, despite the stock market slump. On the whole, the group remained at relatively high income levels in 1937, only 7 reporting incomes below \$100,000 or net deficits. The net incomes excluding capital gains and losses were above \$100,000 in 1937 for all except 2. Even in 1932 more than half reported net incomes of \$100,000 or more. Nearly all of those with net deficits in that year were in that category because of their capital losses (Table 86).

The chief inference to be drawn from these 2 sample studies is that aggregate figures for taxpayers as a whole or for large groups do in fact conceal significant differences in the capital gain and loss experience of various smaller groups and of individuals.