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64. Margenau, *op. cit.*, p. 42.
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66. Margenau, *op. cit.*, p. 37.
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## *The Partiality of Indexing Capital Gains*

A CONSENSUS has emerged among centrist economists that realized capital gains, before they are taxed, should be indexed for inflation in order to exclude phantom gains. Indexing means multiplying the historical cost, or tax "basis," of the asset by a price index before subtracting it from sales price. This, apparently reasonable proposal is, in fact, partial and discriminatory. All assets, not just capital assets, are "taxed" by inflation.

Holders of monetary assets and recipients of fixed incomes are the primary victims of inflation. Depreciable capital owned by individuals and corporations yields phantom income in ordinary use because depreciation write-off is limited to historical cost.

In contrast, the ordinary cash flow to landholders contains no phantom income because there is no depreciation. Partisans of indexing are guiltily silent on this momentous point. Yet land would be the asset most sheltered by the indexing of capital gains under tax law. Land's basis (the value to be augmented by indexing) is not depreciated away (except illegally); and it is the asset most likely to appreciate with (and even without) general inflationary conditions. Land is only taxed on phantom gains at the time of sale, if ever. Since taxable ownership turnover is very slow, about 2–3% per year, land is the asset whose gains are already most sheltered by step-up of tax basis at time of death and of devise. (Step-up of basis amounts to exempting all pre-death gains from income tax.)

Equities gain when inflation lowers the real value of debt. Indexing would then additionally help the debtors, who have already gained from inflation, not the creditors who have already lost.

An invisible creditor that loses is the United States Treasury. Most land carries deferred tax liabilities to be recouped at time of sale. These liabilities include deductions taken by expensing carrying costs on appreciating land. [Such deductions do not lower the basis of property.] Much of the recoupment is phantom when these invisible debts are paid in depreciated dollars.

Under the Haig-Simons rationale these invisible debts also include taxes that should have been collected annually at the time land price rose. When unpaid taxes are accrued in good dollars, but paid later in bad, the recoupment of tax liabilities is only partial. Accrued unpaid tax liabilities are correctly viewed as the Treasury's basis in appreciating assets: it has bought into them by deferring taxes. To index the owner's basis but not the Treasury's basis would cheat the Treasury, *i.e.*, other taxpayers. It is cheated anyway since it does not collect interest on the deferred taxes.

Capital in owner-occupied residences, and personal playgrounds, would gain from indexing even more than depreciable capital does because the basis remains fully intact. Indexing would add to the existing tax bias, already very strong, for capital in this form. Gains on sales of the residence are tax-deferred when one replaces the residence. If one cashes out, the first $125,000 of gain is excluded once in a lifetime. Interest and property taxes are fully deductible even though the counterpart "imputed income" (enjoyment of occupancy) is untaxed.

Selective lightening of taxes on new investment can be justified on incentive grounds; indexing gains would mainly favor old assets and assets already sheltered, notably land.

Ominously, selective indexing of gains would create a new pro-inflation lobby with an interest adverse to the general welfare.

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## *Permanent Vacancies*

SOME MINDS remain open long enough for the truth not only to enter but to pass through by way of a ready exit without pausing along the route.

ELIZABETH KENNY (1886-1952)