

**D.C. Tax Revision Commission Policy Options**  
**Policy Option #34: Reduce the Capital Gains Tax Rate to 3%**  
**For Investors in High-Technology Firms**

**MEMORANDUM**

**Proposal:** Reduce capital gains tax rate to 3% for investors in high-technology firms

**Tax Type:** Business

**Origin:** Mayor Vince Gray

**Commission Goal:** Competition and business growth

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**Current Law**

There is no preference for capital gains in D.C.'s individual income tax. Thus, capital gains are included in taxable income, which is subject to the following brackets and rates:

<u>Taxable Income</u>	<u>Rate</u>
Up to \$10,000	4%
\$10,001 to \$40,000	6%
\$40,001 to \$350,000	8.5%
\$350,001 and above	8.95%

**Proposed Change**

Reduce the tax rate to 3% for capital gains from the sale of stock of a Qualified High Technology Company (QHTC), as defined under current D.C. law. An investor must hold the stock for at least 24 continuous months. A QHTC is an organization that (i) is located in D.C. (ii) has two or more D.C.-based employees, and (iii) derives at least 51% of its gross revenues from D.C. in technology-based services.

The mayor and D.C. Council asked the D.C. Tax Revision Commission to evaluate this proposal.

**Reason for Change**

D.C. does not incent the purchase and sale of stock in QHTCs. By comparison, in Virginia, there is no tax on capital gains from investments in "qualified" technology firms in Virginia made between April 1, 2010 and June 30, 2015. (The Virginia tax credit is limited to \$50,000 per investor and the state cannot distribute more \$5 million in credits per year.) This tax difference could discourage technology start-ups from locating in D.C. Also investors and employees of D.C.-based high-tech firms might move to Virginia, where the top income tax rate (5.75%) is lower, to cash out their capital gains, reducing the revenue D.C. may have gained from such investors.

**Pros**

- Could make D.C. more competitive in attracting and retaining entrepreneurs who invest in high-technology companies and those organizations' employees.

- Might encourage D.C. residents to invest in local high-technology firms. This could make D.C. more attractive to start-up high-technology firms and their employees—a sector targeted by Mayor Vince Gray.

### **Cons**

- Would reduce tax rates for income of some affluent residents. These investors would pay a lower rate on eligible capital gains (3%) than the lowest individual income tax rate (4%).
- Targeting tax benefits is difficult. Some investors might find ways to recharacterize their income as high-technology capital gains to take advantage of the lower tax rate. Other investors might invest without the added incentive.
- Would favor certain types of income over others. A D.C. wage earner and QHTC investor with the same income could have very different tax payments.
- Could lose substantial tax revenue.

### **Revenue Impact**

The Office of Revenue analysis does not have an official estimate for this policy option. A 2012 fiscal impact statement from ORA on the proposal, however, concluded that “if [an eligible high-technology firm] were to have an IPO, depending on the IPO price and the subsequent trading, the revenue losses could be significant.”