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Invitation to a Dialogue: Taxing Capital Gains

To the Editor:

President Obama's State of the Union address and the scrutiny of Republican candidates' tax returns have made income tax disparities a hot topic. Mitt Romney came under attack for paying an effective tax rate of less than 15 percent because his income was mainly in the form of capital gains, including "carried interest" — compensation that has been deliberately structured as capital gains for private equity managers.

Amending our tax rules to narrow the scope of capital gains is difficult, because defining the assets or activities that deserve favorable tax treatment is difficult. (I know. As a Congressional staffer in the '90s, I tried.) But, instead, why not just eliminate the capital gains preference?

Some argue that capital gains preferences promote investment, although the evidence is, at best, mixed. However, the clearest beneficiaries of these preferences are sophisticated tax planners and the wealthy. And now, to even Mr. Romney's skepticism, Newt Gingrich proposes to reduce the capital gains tax rate to zero.

The Tax Reform Act of 1986, signed by President Reagan, raised tax rates on capital gains and lowered rates on ordinary income, but set the same 28 percent top rate for both. The goal: Reduce tax planning devoted to converting ordinary income to capital gains.

The policy worked — briefly. Successive Congresses and administrations raised the top rate on ordinary income (which is now 35 percent) and then reduced the top rate on capital gains (now 15 percent). As the gap between the two rates grew,

so did the opportunities to manipulate the system.

Most tax specialists believe that the time is again ripe for tax reform. One step would be to return to the Reagan days and once again tax capital gains and ordinary income at the same rate.

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Washington, Jan. 31, 2012

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Editors' Note: We invite readers to respond to this letter for our Sunday Dialogue. We plan to publish responses and Mr. Rosenthal's rejoinder in the Sunday Review. E-mail: letters@nytimes.com