How Should the US Tax System Respond to the Growing Wealth Gap:
The Continuing Debate over Wealth Taxes and Other Tax Proposals to Narrow the Gap Between Rich and Poor

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Some Sources on Income and Wealth Gaps


- Pedro da Costa, America’s Humongous Wealth Gap is Widening Further, FORBES (May 29, 2019, at https://forbes.com/sites/pedrodacosta/2019/05/29/Americas-humongous-wealth-gap-is-widening-further/#7cf2c1d342ee


What Wealth Inequality in the U.S. Looks Like

**Wealth Distribution**

**1989**
- The top 10% of Americans owned the majority of U.S. wealth
  - 67% of wealth
- The next 40% owned less than a third
  - 30% of wealth
- The bottom 50% owned a sliver
  - 3% of wealth

**2016**
- The top 10% of Americans owned more of total U.S. wealth
  - 77% of wealth
- The next 40% owned less
  - 22% of wealth
- The bottom 50% saw its sliver of wealth shrink
  - 1% of wealth

Also, about 1 in 10 families in 2016 had negative net worth

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Wealth Concentration at the Top in the US

The top 1% holds as much wealth as the bottom 90%. The top 10% (starting with incomes of $942,000) holds 76% of total wealth. The bottom 50% holds only 1% of total wealth. The 400 wealthiest families hold about the same wealth as the entire African-American population of the country plus a third of the Latinx population.

Three ways to measure a cohort’s share of wealth:

1. Estate tax and mortality data (biased downward due to evasion)
   a. Kupczuk & Saez 2004

2. Fed’s Survey of Consumer Finances (SCF) (biased downward due to voluntary nature and exclusion of wealthiest 400)

3. Capitalization of income from tax returns to estimate wealth (uncertainty from estimating IRRs)
   a. Saez & Zucman 2016: top 0.1% spectacular surge from 1980—to above 20% in 2014
   b. Smith, Zidar & Zwick 2019: to above 15% (with conservative accounting for heterogeneity of returns, and assumption of larger role for private business wealth)

Key Idea: “All sources of information point to an increase in wealth inequality. Exactly how much is very much uncertain and should not be presented as certain.”

Income and wealth inequality in the United States have increased over several decades. While income inequality in the United States was relatively stable from the 1940s to the 1970s, since then wage growth at the top of the income distribution has outpaced the rest of the distribution, and inequality has risen. Wealth has become increasingly concentrated.

“Further, income, wealth, and longevity are each interconnected.”

“[P]eople who have lower incomes tend to live shorter lives than those with higher incomes.”
GAO 19-587 Fig. 5, at 19, Income and Wealth of Older Americans, Estimated Average Wealth plus PV of future income, by quintile, in millions (top quintile on right, lighter blue is Soc. Sec.)
Correlated Disparities

Race, Gender, & Education:

“Income and wealth were consistently lower over time for older households headed by someone who was a racial minority, single, or hadn’t attended college.” GAO Study at 23

Longevity:

“For income, an estimated 52 percent of individuals from households in the bottom quintile of the mid-career earnings distribution were alive in 2014, compared to an estimated 74 percent of individuals from households in the top quintile. The percentages by wealth quintile were similar.” GAO Study at 35
More on the Wealth Gap

• [additional slide(s) expected]
How should the tax system respond to the Income Gap and Wealth Gap?

1. S-Corp/Partnership Labor Income Currently Taxed as Capital Gains
2. Senator Elizabeth Warren’s Wealth Tax Proposal
4. Edward Kleinbard’s Dual Business Enterprise Income Tax (Dual BEIT)
5. Making the Income, Estate and Gift Tax Systems More Progressive
Pass-Through Income as a Significant Driver of Wealth Increase at the Top
THE TWO BASES
Adjusted Gross Income and Wealth
Business Participation by AGI Percentile

- Partnership Income
- S-corporation Income
- Dividend Income from C-corporations
- Sole Proprietorship Income
Business Income Share by AGI Percentile

- Sole proprietorship income
- C-corporation income
- S-corporation income
- Partnership income
Appropriate Tax Response to Such “Labor Income” Increases
Proposals for Wealth Taxes or MTM of CGs
Democratic Egalitarianism

Democratic egalitarianism says that broad-based growth is the most beneficial for the economy, not growth that goes predominantly to the already wealthy. Policies, accordingly, should tend to redistribute downwards, to the extent possible, to ensure that even those at the bottom have a decent standard of living and to prevent those at the top from acquiring plutocratic control of the institutions of government and the economy.

Consider the post-WWII economy when more women were in the work force with men for the first time and the GI Bill allowed returning vets to get a college education, at the same time that various New Deal programs enhanced the possibility for those in the bottom of the wealth and income distributions to have a decent standard of living.
Senator Warren’s Wealth Tax Proposal

• Tax is a small annual bite of a taxpayer’s net worth above a large exemption: 2% on wealth above $50 million, with an additional 4% (total of 6%) on wealth above $1 billion, estimated to generate $3.75 trillion over ten years

• Revenues to be invested in human capital and physical infrastructure that supports the economy
  • Eventual expansion of Medicare to cover all Americans
  • Free public college tuition (similar to the post-WWII GI Bill)
  • Student debt forgiveness
  • Green New Deal physical infrastructure projects (transportation, climate change)

• Anti-evasion provisions included to support implementation
  • Formulaic evaluations of small businesses, unoccupied real estate
  • Increase in IRS enforcement budget
  • 40% ‘exit tax’ on expatriation of net worth about $50 million
  • Minimum audit rate for those subject to the wealth tax
In support of a wealth tax

• Wealth tax expresses a long-held anti-dynasty American value
• Wealth tax directly addresses the increasing concentration of wealth
• Wealth tax protects democratic institutions from corruption enabled by the power wealth wields
  • Neil Buchanan, 2011 Jotwell “The super-wealthy now truly run the show, and they are less shy than ever about doing so.”
• Additional tax revenues are critical for human and physical capital investment
  • Public investment spurs economic growth that builds a sustainable economy
  • Public investment tends to be local, whereas private investment is global
  • Public investment addresses life’s necessities (education, housing, transportation, clean water, nature reserves), whereas private investment often extracts ‘rents’ that simply shift existing wealth from lower quintiles to the already rich
• See, e.g., THOMAS PIKETTY, CAPITALISM IN THE TWENTY-FIRST CENTURY (proposing tax as a means of addressing inequities); WILKINSON AND PICKETT (describing the many ways that US statistics resemble disadvantaged countries, including low literacy rates, high homelessness and teenage pregnancies, significant addiction problems, shorter lifetimes, children in poverty and lower participation in higher education); JOSEPH STIGLITZ, THE PRICE OF INEQUALITY (arguing that inequality and tax policies that bolster inequality create a harmful cycle that lowers the standard of living of ordinary Americans).
The Wealth Tax proposal is “at risk of being short-circuited by unwarranted contention” of unconstitutionality\(^1\)

The argument (put forward most strongly by Eric Jensen) is that a tax on wealth is a direct tax and cannot be assessed on each taxpayer’s net worth at a uniform rate because a direct tax must be apportioned across the different states under the Constitution.

- Constitutional Convention attendees did not have a clear idea of what “direct taxes” were: King asked. Madison’s notes indicate that no one answered.
- Ambiguity about direct taxes served the goal of reaching compromise—was connected with the infamous compromise on counting a slave as 3/5 of a person

This argument relies on a case that invalidated the first income tax statute as a direct tax, *Pollock v. Farmers Loan & Trust Co.* (SCt 1895) (5-4 decision). Like many other SCt decisions exemplified by *Lochner* at dawn of the progressive era, *Pollock* was an example of the Supreme Court’s hostility towards progressive economic policies like worker protection and minimum wages.

Although many of the *Lochner* era cases were later overturned by the Court itself, *Pollock* was not because the nation did so directly via ratification of the Sixteenth Amendment authorizing a national income tax.

Commentators who argue that a wealth tax is unconstitutional assert that wealth taxes must continue to be considered direct taxes because of dicta continuing to name wealth taxes as direct taxes in later Supreme Court cases that hold that various other taxes are not direct taxes because they are not amenable to apportionment.

\(^1\) Dawn Johnsen & Walter Dellinger, *Yes, a wealth tax would be constitutional*, WaPo OpEd (Jan 11, 2020).
The argument for constitutionality

• The need for a national tax system was a primary driver of the Constitutional Convention, which gave Congress the power to tax.

• The ‘direct tax’ concept rests on Articles of Confederation requisitions that could be reasonably apportioned against the states, yielding uniform rates.

• Wealth was then considered proportionate to population within the states and thus susceptible to being taxed by means of an apportioned requisition: it was simply more convenient to use the less easily falsifiable population count for apportioned requisitions.

• The Supreme Court’s 1796 analysis of a carriage tax in *Hylton* saw the error in the earlier supposition. The number of carriages varied from state to state, so *Hylton* recognized that the carriage tax could not reasonably be apportioned and that it therefore could not be a ‘direct’ tax. It was nonetheless within the congressional taxing power. Hence it could be assessed at a uniform rate without apportionment among the states.
  - Such a tax could not be reasonably apportioned because the differences in the tax base would make the rates paid by each state unfair. One state might have 10 wealthy families with carriages, while another state might have 100 wealthy families with carriages. Apportionment of a tax on carriages would be unreasonable in such a circumstance since the state with 10 families with carriages would pay a much higher rate per carriage than the state with 100 families with carriages.
  - *Hylton* involved justices who had taken part in the Constitution’s framing—so their interpretation should be given significant weight.

• Altho’ SCt cases did, almost mechanically, continue to treat wealth taxes as direct taxes in dicta even while finding that other taxes were not direct taxes because they were not amenable to apportionment, those statements about wealth taxes are not precedential.

• With the change in concentration of wealth, it is clear that any broader type of wealth tax that looks at all assets (rather than just carriages) would also fail to satisfy the definition of a ‘direct’ tax capable of apportionment. A wealth tax clearly cannot function as an apportioned direct tax because apportionment forces non-uniform rates—the wealthy in poor states would be assessed tax at absurdly high rates while the wealthy in rich states would be assessed tax at unfairly lower rates.

• Arguments claiming that a wealth tax is a ‘direct’ tax and hence illegitimate simply misunderstand what a ‘direct’ tax is.

\(^2\) See Calvin Johnson, ABA Tax Times (Summer and Fall 2019).
Constitutional Argument in a Nutshell

A direct tax is one that can be reasonably apportioned resulting in uniform rates among the states.

Apportionment forces non-uniform rates when the tax base per capita (e.g., carriages, wealth) is uneven among the states.

Accordingly, taxes such as wealth taxes with tax bases that vary among the states cannot be direct taxes because they cannot be apportioned.

National Federation of Independent Businesses v. Sebelius (SCt 2012) follows Hylton by holding that the Affordable Care Act tax on failure to have or buy insurance is not a direct tax because “apportioning such tax would make little sense”.

Wealth Tax Enactment Faces Other Difficulties

1. Properly determining taxpayer’s net wealth subject to tax by expanding on/improving estate tax valuation rules, including formulaic valuations for harder-to-value items, and information reporting requirements (but still much of base in control of owner with no potential third party reporting)
   - Publicly traded assets
   - Collectibles, luxury goods, yachts, jets
   - Closely held businesses and non-owner occupied real estate
   - Pensions and other financial assets

2. Effectively countering tax evasion (else will raise little in revenues)
   - Warren proposal supports significant anti-evasion measures including (but not limited to)
     - Substantial increases to IRS enforcement budget
     - Minimum audit rate for taxpayers subject to the wealth tax
     - 40% ‘exit tax’ on net worth above the wealth tax threshold for expatriation
     - Systematic third-party reporting using existing tax exchange agreements under the Foreign Account Tax Compliance Act
   - Nonetheless, the wealthy have sophisticated advisers and techniques for secreting their wealth—see, e.g., Michael Forsyte et al, *Earning Riches by Exploiting a Poor Nation: Angolan Entrepreneur Builds Shell Empire*, NYT, 1/20/20 (discussion of Angolan heiress’s corruptly hiding away millions in state assets with assistance of professional service firms such as McKinsey).

3. Overcoming political and conservative aversion to wealth taxes:
   - Con: Undue power over policy exercised by wealthy donors to political campaigns: extreme wealth works to perpetuate itself, including by making taxing the rich unthinkable
   - Pro: Strong public support for higher taxes on wealthy and corporations runs counter, like the fear of communism in the New Deal era
   - Con: Tendency of media pundits (a consensus chorus of nitpickers and naysayers) to mock significant changes in favor of status quo or middle-of-the-road polices
   - Pro: Willingness of Democratic candidates to take strong positions to counter Trump administration’s adverse treatment of low-income and middle class (2017 tax legislation; 2020 cutback on food stamps that will leave 3.5 million current recipients hungry, etc.)
   - Con: Current conservative SCt Justices might be ideologically prone to rely on Pollock anyway
   - Pro: Chief Justice Roberts’ interest in maintaining the integrity of the Court requires a reasoned opinion on wealth taxes comprehending that direct taxes are only those that are reasonably apportioned

4. Finding consistent sources of funding once wealth taxes successfully reduce the ultrawealthy class (assuming that actually happens)
   - Wealth tax would raise about $250B per year (PWBM analysis)—a small bite annually equalling about 0.24% of US net worth of $114T
   - Actual reduction of ultrawealthy wealth concentration is a panacea, but like sin taxes, the wealth tax does have the goal of reducing the concentration of wealth that makes the significant returns from pennies on the dollar possible at the outset. See, e.g., Megan McCardle, *Warren’s wealth tax might sound like nothing. But the numbers aren’t small*, WaPo (Nov. 12, 2019).
   - In an ideal world, the significant sums raised from the wealth tax will successfully fund a variety of public investments that, like Post-WWII GI Bill and other progressive programs, created a booming near-egalitarian economy in which most boats were able to rise. That would allow the regular income tax system to take over the primary generation of revenues (assuming a number of the needed reforms to undo the system’s bias towards wealth are accomplished)
Market Myths of Standard Economic Theory

overstate criticisms of the Wealth Tax

Underlying much of the objection to a wealth tax is the **idea promoted by Mitt Romney** in the 2012 election that **capitalists and owners are the real “makers” who merit their dominant position in society over the bottom 50% who are the “takers.”** *See, e.g.*, Romney divides society into the wealth-makers and the wealth-takers, The Guardian (Sept 19, 2012).

Counter: It is **highly unlikely that the most wellpaid private equity & hedge fund managers and CEOs are adding value proportional to their pay** as claimed by the marginal productivity theory. *See, e.g.*, Stiglitz, The Price of Inequality (2012).

This is exacerbated by unrealistic complaints from the ultrawealthy of the disruption to the economy if these “makers” were to be taxed, along with claims of high value provided by these wealthy actors. *See, e.g.*, Steven Rattner, *The Warren Way is the Wrong Way*, NYTimes OpEd (Nov. 4, 2019) calling it a ‘terrible prospect’ that would be “highly disruptive” paid for by a “mountain of new taxes” that would expand government (including a department of economic development) and “dismember” “global champions” like banks and tech giants and eliminate “private equity that plays a useful role in driving business efficiency” and require corporations to exercise social responsibility by considering the interests of employees, customers and communities, not just shareholders, by giving workers board seats—all essentially “mucking up the essence of our free enterprise system.”

- Counter: Rattner apparently forgets the many ways that current tax policy acts to pick winners and losers of industry—e.g., the many permanent subsidies for the fossil fuel industry, compared to very short-term provisions to aid startup of ‘green’ wind and sun power industries.
- **Yet even Rattner acknowledges the need to modify current wealth-favoring tax policies**: eliminating the CG preference and the estate tax exemption of all gains (through the basis step-up for heirs), raising the rate on ordinary income, and dealing with carried interest and other tax expenditures for the rich.
Standard Economic Theory tends to

1. Undervalue public investments compared to private investments—PWBM adopts traditional CBO rule of thumb that public investments produce only 50% of private investment benefits whereas in reality, closer to the opposite
   - Public investments generally are made locally; private are global
   - Public investments address infrastructure needs that facilitate commerce, jobs, R&D and the arts; private investments often just rearrange existing enterprises for private gains at significant costs to the overall economy in the long term (e.g., private equity leveraged buyouts of profitable companies with downsizing of workers and sell-off of assets for quick profits)
   - Public investments support education and training of the workforce in ways that permit transitioning to different jobs as economy cycles through different trends; private tends to penalize workers unable to transition on their own
   - Payback period (closure rule) in analyses shortchanges longer-term benefit of public investments, whereas discount rate should capture risk and timing (i.e., arbitrary cutoff doublecounts negatives).
   - Warren’s proposal includes not just pre-K (with 15-20 year payoff start) but also K-12 and higher ed, with much earlier benefits in terms of jobs and salaries
   - Education’s IRR is higher than private capital investment, even with delays (around 20%)

2. Overrate likelihood of future U.S. liquidity crisis from high debt/deficit funding (Assuming fixed trend of 40% foreign investment in US Treasuries)
   - Treasury now plans to renew issuance of 20 year Treasuries to take advantage of low interest rates
   - Credit rating agencies comment on strength of government bonds, not weakness

3. Build conventional estimates of impact assuming significant tax avoidance without acknowledging the various safeguards in the Warren Proposal
   - Even assuming less avoidance results in worse outputs from standard models, under assumptions that more revenue from higher effective tax rates causes more negative changes in economic activity

4. Exaggerate harm to private investment by treating the investment capacity of the ultrawealthy as irreplaceable by others
   - US net worth about $115 T, so if US ultrawealthy do pull back investment, US ‘mere monied class’ (P90-P99, who control significant portion of wealth) will move to fill gap
   - Global net worth totals about $315 T, so foreign investors can also move to fill gap; PWBM adopts arbitrary fixed 40% cap to foreign investment from government analysis, but seems unrealistic for today’s global capital glut stymied by a low interest rate environment

5. Forecast unrealistic parallel reduction in US capital growth rates
   - Taxing wealth could induce greater savings in productive investments and less luxury consumption
   - Public investment tends to be local, whereas the private investment displaced tends to be global so public investment would likely act as a stimulus to growth rates

6. View high-end wealth as merited (greater ability) in spite of the disproportionality of return to value added
   - By relying on the markets to make all determinations under a rigid theory of rational economic man seeking utility and the marginal productivity theory, standard economic theory simply assumes the concentration of wealth at the top is merited by greater ability, rather than by the flexibility those at the top may gain with lesser moral scruples or altruistic motivation, resulting in greater willingness to fleece suppliers (Trump’s failure to pay for 100 pianos) or exploit low-wage workers (on-demand schedules rather than regular work weeks, low wages even in times of high profits)

7. Favor small government and disregard the impact of inequality on the stability of democratic institutions from oligarchic power
   - Fundamental ‘belief’ in the market as an appropriate deciding factor inclines to assumptions that favor the status quo
Senator Wyden’s Capital Gains Proposal: “Treat Wages Like Wealth” (TWLW)

“Americans who work for a living pay taxes with every paycheck. Meanwhile, those whose income comes from wealth can defer their taxes, often for years. If they pay taxes at all after taking advantage of myriad loopholes, they can pay a lower rate than someone who earns a paycheck.” TWLW at 3.

“[T]he average family worth more than $100 million has never paid tax on more than half of its wealth.” TWLW at 3 (quoting Fed Res. Board (2013)).

Proposal applies to a fraction of the richest 1 percent, is estimated to raise between $1.5 trillion and $2 trillion over 10 years, and will be entirely dedicated to funding Social Security benefits through 2095.
Rationale for TWLW Proposal

1. Unfairness of preferential tax rates for LTCGs in current code that disproportionately benefit wealthy taxpayers with considerable investment income.
   • Current treatment: top rate on LTCG is 20% while top rate on ordinary income is 37% (3.8% Medicare and net investment income taxes would also apply)
     
     In 2018, almost 70 percent of all realized capital gains went to the top 1 percent. More than 50 percent of realized gains went to the top 0.1 percent. (Tax Policy Center 2018)
   • Proposal treatment: CGs and ordinary income taxed at same rate, with ultra-wealthy taxpayers’ gains taxed using an anti-deferral accounting system.

2. Difference in treatment of ordinary and CG income creates opportunities for tax avoidance and wealth accumulation unavailable to most Americans. The wealthy can:
   • Defer taxation by delaying dispositions to avoid realizing STCGs (taxed as ordinary income) or LTCGs
   • Seek to convert capital losses to ordinary losses deductible against higher-taxed wage and business income
   • Structure business arrangements to receive CGs rather than salary income, especially in private equity
   • Borrow against capital assets to maintain luxury lifestyle without actually spending down wealth
   • Retain assets til death when they will pass to heirs with a step-up in basis, resulting in no tax liability ever for the appreciation during decedent’s lifetime.
Components of TWLW Proposal

1. Eliminates CG Rate Preference
   a. CGs taxed at same rates as ordinary income
   b. Credit or exemption would protect middle class taxpayers from higher taxes on limited capital income

2. Anti-Deferral Accounting System Applies to
   a. Individuals, estates or trusts with >$1M annual income (not counting unrealized gains) or >$10M assets for 3 consecutive years (may include years prior to enactment)
   b. Once applies, continues to apply until the applicable taxpayer fails to satisfy either income or asset test for 3 consecutive years (then can elect not to continue)
   c. Asset values for certain types of assets excluded for determining whether taxpayer is covered, up to stated threshold that would be indexed for inflation
      i. Personal residences up to combined total value of $2M
      ii. Retirement accounts up to $3M
      iii. Family farms up to $5M

3. Special Rules
   a. Pass-throughs would apply the rules at the partner or S corporation shareholder level, treating the interest as a nontradable asset
   b. C Corporations would generally not apply anti-deferral accounting to their assets, but anti-abuse rules may be necessary to prevent use of corporations to avoid shareholder tax
   c. Phase I and Transition rules “smooth the change” (otherwise, entrepreneurs like Mark Zuckerberg would owe a significant lump sum tax for appreciation of Facebook stock since inception upon passage)

4. MTM Taxation of Tradable Assets
   a. What: Publicly traded stocks, bonds, derivatives, securities are marked to market at the end of each tax year
   b. How: Taxpayers covered by system pay tax on the gain or deduct the losses (subject to certain anti-abuse limitations on losses)

5. Lookback Charge Method for Non-Tradable Assets
   a. What: real estate, business interests, collectibles (not household goods, subject to anti-abuse rules)
   b. How: upon realization (other than in transaction currently given preferential treatment, such as sections 351 or 721), tax will be based on a lookback charge intended to tax as though the assets had experienced accrued gains between the time they were acquired and sold, eliminating benefit of deferral of taxation. Lookback charge methods could take form of:
      i. Tax on gain plus interest charge on deferred tax
      ii. Yield-based tax
      iii. Tax on gain plus surtax based on asset’s holding period

6. Taxation of partially exempt assets in 2c:
   a. Lookback charge method in 5b applies to personal residences (any number, for aggregate value above the threshold) and to family farm (for value above the threshold)
   b. Neither MTM nor Lookback Charge method applies to values in retirement accounts (IRAs, 401ks, etc.) above threshold—those are taxed under current rules
**TWLW example 2:** Taxpayer meets either income or asset test (or both) in each of the three preceding years, so is an applicable taxpayer in year 4.

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<th>Applicable Asset Values</th>
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<tr>
<td>3</td>
<td>$900,000</td>
<td>$11,000,000</td>
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**TWLW example 3:** Taxpayer becomes applicable taxpayer in year 4 and remains one in years 5 and 6. For year 7, taxpayer can elect whether or not to remain in MTM system.

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<th>Year</th>
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Criticisms of MTM of Capital Gains

• Ending deferral amounts to a higher tax bite
• May cause decline in savings
• Decline in savings may cause reduction in productive investments
• Reduction in productive investments may cause decline in GDP, wages, and growth


Counters to those criticisms are similar to the economic criticisms about wealth taxes
Kleinbard’s Dual BEIT Proposal

• Comprehensive business income tax reform proposal that has received surprisingly little attention.

• Main aims include:
  (1) avoid distorting business choices re. organizational form, financing methods, asset choice;
  (2) thereby reduce the efficacy of tax planning;
  (3) shift taxation of certain “normal” returns from the entity level to the individual level;
  (4) address use of corporations as a tax shelter for owner-employees’ undistributed labor income.
A few key details of the Dual BEIT

- All businesses (not just C corporations) are taxed at (say) 25%.
- They get a cost of capital allowance (COCA) deduction.
  - COCA deduction = tax basis in capital investments X the Treasury bond rate (say).
  - Results in exempting “normal” returns at the entity level.
  - Makes the entity-level tax expensing-equivalent (a la cash flow consumption taxes)
  
  BUT:

- Individual owners (of debt, equity, or anything else) pay tax on the COCA rate X their basis.
  - So the normal investment return is taxable after all, but directly to individuals rather than to entities.

- “Superconsolidation” rules for related entities, so WW tax on expensing-equivalent base.

- Applies “labor-capital income centrifuge” to companies’ extra-normal returns that are
deemed to represent controlling owner-employees’ undistributed labor earnings.
  - E.g., Facebook might face higher tax rate on deemed salary underpayments to Mark Zuckerberg.
The Dual BEIT and Wealth Inequality

• A central aim is simply to rationalize business income taxation (rather than addressing inequality as an end in itself).

• But:
  
  (1) Could make it easier to tax US individuals’ “normal” returns at a positive rate.
      Individual vs. corporate residence, inside vs. outside basis, defeats various types of tax planning, mitigates realization woes.

  (2) Addresses use of lower corporate rate as a tax shelter.
      E.g., why tax Zuckerberg’s undistributed share of Facebook earnings @ only 21%?

  (3) Rationalizing business income taxation may be key to retaining income taxes’ role as a distributional tool.
Higher & More Progressive Income Tax Rates?

• For decades, economists (even on the left) tended to favor relatively lowish & flattish rates compared to pre-1981 U.S. practice.
  • E.g., the optimal income tax (OIT) literature founded in the 1970s by the Nobel Prize-winning James Mirrlees.

• But such consensus is now gone.
  • E.g., see work by Peter Diamond (also a Nobelist) & Emmanuel Saez urging a top rate in the neighborhood of 70%.

• They argue that this would (or could) be the revenue-maximizing rate at the top.
A 70 percent top income tax rate?

• Issues being debated include (a) what is (or could be) the revenue-maximizing rate at the top, (b) whether the choice of such a rate (or even a higher one!) is desirable, and (c) how the “top” ought to be defined for this purpose.

• Having such a high rate is far from unprecedented in the US – including in high-growth eras – but suppose it was more of a true effective rate than previously.

• Vs. changing the tax base, raising top rates has (a) the disadvantage of magnifying existing distortions, but also (b) the advantage of avoiding the imponderables associated with making big structural changes.
Higher estate and gift tax rates?

• Another way of addressing the rise of high-end wealth inequality would be to raise estate & gift tax rates.
• This could be accompanied (or not) by tax base changes aimed at addressing estate & gift tax planning.
• Exemption amounts could also be reduced, depending on the proponents’ particular distributional aims.
• Vs. using wealth taxation, its pros include (a) familiarity & constitutionality, (b) its not needing annual valuations, & (c) its addressing inheritance in particular (if one views dynastic wealth as the problem).
• Its cons include its (a) inviting the use of a greater range of tax planning responses, (b) relying on asset valuations at very specific times that may be idiosyncratic.
Questions and Discussion