Taxing Capital Income

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Politics has changed regarding taxing the rich

- For the last 40 years, the prevailing philosophy has been to "broaden the base and lower the rate" to achieve maximum tax efficiency and revenue.

- Now, the thought has shifted to consider the unfairness of taxing wages at higher rates than income from investments. Remember Buffet's comments several years ago regarding his tax rate versus that of his secretary…?

- For the top 1%, 3/4 of their income is recharacterized as investment income (private equity, dividends/ capital gains, and carried interest.)

- For 85% of Americans, 80% of their income is from wages.

Several proposals being recommended

- Wealth tax
- Market-to-Market taxation of tradable investments annually
- Surtaxes on high earners
- Tax all income at the same rates…?
- End of the stepped up basis at death

Wealth Tax

- As we have discussed, most European countries have repealed the wealth tax as it is far too difficult to calculate and does not justify the cost benefit to administer.

- There seems to be a growing consensus that any wealth tax passed will be challenged as unconstitutional and tied up in court for years (delaying any revenue benefit.)

- The argument for the wealth tax is that it is basically a form of property tax (only a property tax is not assessed by the Federal government.)

- Public opinion seems to support this tax as it would only apply to very wealthy individuals yet the reality is that it is unlikely to raise sufficient revenue to fund increased government spending.

Market-to-Market

- Senator Ron Wyden, D /Oregon, released a 40 page proposal to tax equities/funds on a market-to-market basis each year. However, the document asks more questions than stating firm positions on how this would work in practice.

- Congresswomen Jan Schakowsky, D-Illinois, and Alexandria Ocasio-Cortez, D-New York, will be releasing a new bill titled, Fairness in Taxation Act.

- The Congresswomen call their version of market-to-market taxation “pay as you profit.” There is currently $3.2T in tradable assets for this potential tax.

- Example - Apple stock rises 50% during the calendar year. Your 1099 for the year would reflect that gain as taxable regardless of whether or not you sold the stock.

- Neither proposal has finalized what happens in year 2 if the stock price goes down. One idea would be loss carryforwards to offset current year gains or a refund in year 2 (highly unlikely.)

“Millionaires Surtax”

- Senator Chris Van Hollen, D/ Maryland, and Congressman Don Beyer, D/ Virginia propose a “Millionaires Surtax.”

- The proposal calls for a 10% surtax on all income over $2M for Married, Filing Jointly taxpayers and $1M for Single filers.

- Projected to raise $635B over 10 years and apply to less than the 1% of the top earners.

- Argument for this proposal is based on fairness and closing the wealth gap in our society.

Tax all income at the same rates

- End the preferential tax rates for dividends, capital gains, carried interest.

- Simple and easy to administer

- Huge opposition from a large portion of the electorate. Obama floated this idea in his second term with significant opposition from his supporters.

- Raise capital gains tax to 28-30%? There have been multiple studies and papers published since 1990 analyzing the behavioral responses and projected revenue as the individual has control over when a gain is realized. The range of revenue projections vary from $5B to $31B annually (no consensus on the revenue potential.)

End the stepped up basis at death on assets

- Again, simple and easy to administer but would likely face huge opposition from a large portion of the electorate.
- Some believe that this might be feasible with modest exemptions such as \$1M-\$2M in assets.
- Likely to raise less revenue, but a significant first step in reducing inequality.

Key guidelines for tax policy

- Experts evaluate complexity
- Projected revenue
- Transactional? (will it distort economic behavior)