Tax Policy

Taxing Unrealized Gains (“Billionaire Tax”)

Issue

President Biden and certain key lawmakers, including Senate Finance Committee Chairman Ron Wyden (D-OR), have proposed a mark-to-market regime for capital assets in which built-in gain is taxed on an annual basis, regardless of whether the asset is sold. President Biden’s proposal would impose a minimum 25% tax on the combined income and unrealized gains of taxpayers with $100 million in income or assets.

Taxpayers would report the total basis and estimated value of their assets on December 31 of each year. Tradable assets (e.g., public stock) would be valued using end-of-year market prices. Real estate and other less liquid assets would be valued at (a) the greater of original or adjusted cost basis, (b) the last valuation event from investment/borrowing/financial statements, or (c) other undefined methods.

Under the President’s proposal, “illiquid” taxpayers, defined as taxpayers whose tradable assets make up less than 20% of their wealth, could elect to pay the minimum tax only on their tradable assets, with a deferral charge of up to 10% when gains on non-tradable assets are eventually realized.

Minimum tax payments would be treated as prepayments creditable against subsequent tax liability on realized capital gains. The tax in the first year would apply to prior, built-in gains and could be paid over a 9-year period. The tax in subsequent years could be paid over a 5-year period.

In the last Congress, efforts to include a version of the mark-to-market regime in tax reconciliation legislation were unsuccessful when they ran into resistance from moderate Congressional Democrats.

The Roundtable’s Position

Taxing unrealized gains would upend over 100 years of federal taxation, require an unprecedented IRS intrusion into household finances, and create unknown and likely unintended consequences for the U.S. economy.

- At its core, the proposed tax on unrealized appreciation is a federal property tax that would apply year-in, year-out, regardless of whether one’s property (real estate, stock holdings, paintings, jewelry, etc.) is generating any actual income, earnings, or profits for the taxpayer.

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The Roundtable's Position (Continued)

- The tax would require the IRS to police households as they identify, tabulate, and value all their worldly possessions. The tax would thrust the IRS into a new and unwelcome role. The agency would become a permanent, live-in accountant and watchdog over every aspect of households' finances, consumer activity, and economic life.
- Tens of thousands of taxpayers will need to prove that their wealth falls below the relevant threshold ($100 million).
- Supporters of the tax want to extend it to an even larger number of taxpayers. Senator Wyden's original proposal would have applied the tax to the unrealized gains of households with $1 million in income or $10 million in wealth.
- History suggests the tax would eventually apply to everyone. In 1913, the federal income tax applied to 1/3 of 1% of Americans. Ten years later, it applied to seven million Americans. Today, it applies to more than 150 million households.
- Revenue generated by the tax ($38 billion/year) is insufficient to make even a dent in the budget deficit ($1.5 trillion in 2022).
- Past attempts at wealth taxes in other countries have failed overwhelmingly because they were fraught with administrative problems, lacked public support, and had very little impact on income distribution. Of the 12 comprehensive wealth taxes that existed in the developed world in 1990, only three remain today.
- The tax will trigger wasteful disputes and litigation, detracting from productive economic activity. Annual valuation requirements will require costly appraisals. Valuation disagreements will be a constant source of audits, disagreements, and administrative appeals with tax collectors.
- The potential unintended and unknown consequences of taxing unrealized gains are immense. The longstanding principle that taxes are deferred until a gain is realized encourages taxpayers to put capital to work on projects that won't pay off for many years. By taxing business assets and investments annually, the tax will remove one of the major incentives for patient, productive capital investment. The differential tax treatment of liquid and illiquid investments will distort markets and give rise to wasteful new tax shelters and taxpayer games.

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The Roundtable’s Position (Continued)

- Charities, educational endowments, and churches will suffer. The ability to contribute appreciated assets to public charities and other nonprofits without owing tax on the unrealized gain provides an important economic inducement for philanthropic giving. Taxing unrealized gains on an annual basis will eliminate this economic incentive.
- The proposed tax is quite possibly unconstitutional. Supreme Court jurisprudence has applied a realization requirement to determine whether gains or profits constitute income taxable under the 16th Amendment. Since the proposed tax applies to both realized and unrealized gains, it may go beyond the boundaries of Congress’s taxing power.