The NY Billionaire Mark-to-Market Tax Act: Revenue, Economic, and Constitutional Analysis

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The new proposed bill would tax NY billionaires' unrealized gains. In 2020, all NY billionaire-residents would be taxed on all of their unrealized gains (and have the option to pay the amount over 10 years with a 7.5% annual interest charge). In subsequent years, NY billionaire-residents would be taxed each year on their annual accrued gains. Future NY residents would get taxed solely on their gains accrued after becoming a NY resident.

Revenue analysis.

We estimate that the Act would generate $23.2 billion in additional revenue for the State of New York for 2020 (based on NY billionaire-residents wealth as of July 29, 2020). We have assumed conservatively that each billionaire-resident has a tax basis equal to 50% of the fair market value of their wealth. Our estimate is therefore approximately equal to 8.82% times 50% of the collective $530 billion wealth of the 120 NY billionaires. In subsequent years, the annual mark-to-market tax on billionaire-residents' future gains is expected to generate approximately $1.2 billion per year (over and above current revenue).

Note that all of these revenue estimates only account for the additional tax revenues that would be paid to the State of New York and do not include any additional tax revenues that might be paid to the City of New York or other New York localities that levy income taxes and that might conform to this Act.

Initial year scoring. This scoring is done using the Forbes billionaires list in real-time (using wealth as of July 29, 2020) and assuming conservatively that each billionaire has a tax basis equal to half of his or her wealth.[1] The collective wealth of the 120 NY billionaires on the Forbes list is $530B, which implies gains of 50%*$530B=$265B. A tax of 8.82% on such gains raises $23.4B. The relief provision that the tax cannot exceed 25% of wealth in excess of $1B reduces scoring by $.2B for a scoring of $23.2B.

Subsequent years scoring. For subsequent years, we assume that billionaires' wealth increases by 5% per year, approximately the rate of growth of the economy in nominal terms.[2] We assume that half of those gains are not realized. This is consistent with the fact that half of wealth is unrealized gains. Realized gains do not increase revenue as they were already taxed. Therefore, we estimate that the billionaires mark-to-market tax will raise 8.82% of 2.5% of NY billionaires' collective wealth each year over and above the current tax on realized gains only. Using current July 2020 wealth, this is 8.82%*2.5%*$530B=$1.2B. This revenue is only .22% of the billionaires' wealth and it will grow with the size of NY billionaires' wealth in subsequent years.[3] It is important to stress that this revenue estimate for subsequent years will depend on the continued evolution of billionaires' wealth, which is uncertain.

[1] Survey of Consumer Finance data and estate tax data show that unrealized capital gains constitute approximately half of the wealth among the wealthy. Furthermore, the share of unrealized capital gains increases at the very top of the wealth distribution. Therefore, the one-half assumption for billionaires is conservative.
[2] This is also a conservative estimate because the wealth of the Forbes 400 has grown much faster than the economy since 1982 (4.5 points faster per year on average).
[3] As mentioned above, the Forbes 400 wealth has grown much faster than the economy. Hence, even with a .22% additional tax, it remains conservative to assume that billionaires wealth grows at the rate of the economy.

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What is certain is that the subsequent revenue flow is going to be small relative to the initial tax on the stock, at least in the short run.

Notes. We have assumed that the Forbes billionaires list is accurate on average. While it can sometimes exaggerate wealth (e.g. President Trump), it is more likely that it misses some billionaires that are not highly visible (such as heirs from older fortunes rather than business owners-managers). Billionaires may try to minimize the value of their wealth but this will be difficult for wealth that is primarily in the form of shares in large businesses, some of which are publicly traded and others which have many investors and hence a record of share transactions.[4] The bill includes robust enforcement and there are only slightly more than 100 billionaires in NY so that each taxpayer can be carefully audited.

Economic impacts

Billionaires leaving NY state. The bill is structured in such a way that 2020 NY billionaire-residents have to pay the tax on their unrealized gains. Having been a resident for over half a year triggers residency for NY tax purposes. Hence, NY billionaires who haven't left NY by July 1, 2020, are going to be residents for the 2020 tax year and hence liable for this tax no matter what. As a result, current NY billionaire-residents would not face any substantial new incentives to leave the state.

Billionaires coming to NY. Prospective billionaires thinking about moving to NY would not be taxed on unrealized gains accumulated before becoming a NY resident; only future gains made after becoming a NY resident would be subject to tax through this Act. Therefore, the Act would not create any substantial new incentives to avoid becoming a NY resident.

Ongoing Effects. For all billionaires, old residents and new entrants, alike, there would be a continuing slight additional tax due to continuing mark-to-market taxation of future gains, but this tax is relatively small (.22% of wealth per year) and hence should affect residency decisions less than pre-existing and larger income tax differences across states.[5]

Billionaires businesses. The vast majority of NY billionaires own large businesses. These individuals can easily borrow to pay their NY state tax liability, and interest rates are currently at all-time lows. Therefore, the tax will not require the billionaires to liquidate their holdings and in all events the tax is small enough (the initial tax is 4.4% of wealth on average but payment can be spread out over 10 years) to leave their control of the business intact. For example, while we would anticipate that Michael Bloomberg would borrow to pay his tax (because the annual income and gain from Bloomberg LP is greater than current interest rates), even if Michael Bloomberg were to sell a stake in Bloomberg LP to pay the NY tax, his interest would shrink very slightly but he would still be in full control of the company.

Constitutional Analysis

[4] We do acknowledge that the wealth of some billionaires, such as Mayor Bloomberg, is principally in a non traded business with no significant outside investment.

[5] There is mixed evidence on how residence of taxpayers responds on tax differentials across states. Young, Cristobal, Charles Varner, Ithai Z. Lurie, and Richard Prisinzano. 2016. "Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data." American Sociological Review 81 (3): 21–46 find modest responses to differences in income taxes while Moretti, Enrico, and Daniel J. Wilson. 2019. "Taxing Billionaires: Estate Taxes and the Geographical Location of the Ultra-Wealthy." NBER Working Paper 26387 find larger responses to differences in estate taxes. In all cases however, the state tax rates are small enough to be below the revenue maximizing tax rate.

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The New York Constitution clearly and unambiguously permits New York to tax unrealized income through a mark-to-market regime as in this Act. Somewhat more tricky issues arise under the federal Constitution with respect to taxpayers who enter or leave New York for other states, but the bill includes a number of provisions designed to resolve any possible issues under federal Constitutional law. As a result, the new proposed bill is clearly authorized by both the New York and the Federal Constitution.

The New York Constitution. The New York Constitution clearly permits income taxation of residents, including on their unrealized income. Article XVI, section 3, of the New York State Constitution states that:

> "Intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally."

This provision only prohibits New York from taxing wealth in the form of intangible personal property "ad valorem", based on its overall value. The mark-to-market tax does not tax overall value; it taxes only appreciation. Thus, if a billionaire's assets do not increase in value, the billionaire would pay no tax under the mark-to-market tax. An ad valorem tax, in contrast, would tax a billionaire regardless of whether the billionaire's assets appreciate. Therefore, the mark-to-market tax is not prohibited under Article XVI, section 3. Moreover, the provision clearly authorizes a tax measured by income, which is what a mark-to-market tax does.

The Revised Record of the Constitutional Convention of the State of New York, April fifth to August Twenty-Sixth, 1938, Volume II, at 1115, is even more clear on this point: "In other words, we want to make it impossible for the Legislature itself, or for the Legislature to delegate the right, to levy an excise tax on the mere possession of the property. In other words, the property may enjoy that privilege or it may be used for some purpose, and then you can levy an excise tax on it if and when it is used." Again, the New York Constitution prohibits only "ad valorem" taxation of intangible personal property based "solely because of the ownership or possession thereof" but explicitly authorizes taxation of benefits received from owning property including "any excise tax measured by income generally." Nothing in the New York Constitution or any relevant case law suggests in any way that this authorization is limited to only realized income. Indeed, New York already taxes some unrealized income as part of its general income tax by conforming to sections 475 and 1256 of the Internal Revenue Code, requiring mark to market for certain dealers in securities and "section 1256 contracts".

The Federal Constitution. Federal Constitutional law includes a number of doctrines designed to mitigate concerns about possible double taxation by multiple states. With respect to this Act, these doctrines primarily relate to only taxpayers who might enter New York from another state or leave New York for another state. Constitutional precedents support that New York can tax gains (including unrealized gains) that were accumulated while a taxpayer was a New York resident and also gains that may have been accumulated prior to a taxpayer becoming a New York resident so long as those gains were not taxed by any prior state of residence. For former New York resident taxpayers who might leave New York for another state, the new proposed bill would not in any way tax any gains accrued after the taxpayer leaves New York, so there should be no concerns with respect to such taxpayers. For current New York resident taxpayers who previously entered New York from another state, the new proposed bill includes provisions designed to prevent the possibility of taxing gains that were previously taxed by any prior state of residence. These provisions have effects that (1) would increase the basis of taxpayer's assets for New York tax purposes to account for any unrealized gains that might be taxed by a mark-to-market or deemed-realization regime that might be adopted by another state that a New York taxpayer might reside in before moving to New York, (2) would, for taxpayers who entered New York from another state or jurisdiction in 2020 or previously, offer credits for any taxes paid to any prior state or jurisdiction of

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residence for any gains that the taxpayer can show were accumulated prior to the taxpayer becoming a New York resident, and (3) would, for new entrants after 2020, step-up basis for purposes of the new NY mark-to-market regime to the fair market value of a taxpayer's assets on the last day of the last tax year before the taxpayer became a New York resident. Together, these provisions eliminate any possible Constitutional concerns that might otherwise arise from New York taxing gains that could also be taxed by a prior state of residence.

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