

Capital Gains Withholding

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Why raise more revenue from capital gains?

Revenue: Few other taxes can fund trillion-dollar proposals

Fairness: Business deduction consensus means Bezos pays nothing

Realization-at-death alone may be insufficient

Realization of capital gains at death

- Currently: Capital gains are taxed only upon sale
- If Bezos gives stock to kids, cap gains are never taxed
- Proposal: Treat death like a realization/sale event

Issues

- Limited revenue: \$450B over ten
- Taxpayers continue to defer, waiting for repeal

⇒ Mark-to-market taxation of capital gains

Mark-to-market faces three key obstacles

Mark-to-market taxation of capital gains: Immediately tax capital gains, without waiting for sale or death

Issues

1. **Valuation:** Scary to tax uncertain private gains
2. **Liquidity:** Scary to force sympathetic taxpayers to liquidate

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⇒ Wyden Plan: Immediately tax liquid asset gains above \$20M in wealth. Levy deferral charge on illiquid assets.

3. **Robustness:** Future Congresses can easily spare the wealthy by repealing the deferral charge

Capital gains withholding can help

Proposal: The very wealthy must prepay 90% of their estimated capital gains taxes over a nine-year period

- Withheld amounts are credited back upon asset sale or death
- Illiquid taxpayers pay via no-risk gov loan, scored like cash
- Applies only to families with wealth above \$50M threshold

Withholding is a hybrid:

- Like pure mark-to-market: IRS gets trillions now
- Like Wyden: Private assets do not need to be liquidated
- Like realization-at-death: Ultimate tax liability is still calculated at sale or death

Withholding can help address the three key obstacles

- 1. Valuation:** Withheld taxes are merely an *estimated prepayment*
 - Overpayments will be refunded upon sale or death
 - Overpayments will be rare b/c payments are smoothed and collected only up to 90% of liability
- 2. Liquidity:** Smoothed taxes, can pay via no-risk gov loan
- 3. Robustness:** A future Congress can spare the wealthy only by mailing them obscenely large refunds

Example A: Typical person pays like a regular income tax

A. Typical rich: \$200M in wealth and no unrealized gains in 2020. Earns \$10M in unrealized gains on Apple stock in 2021.

- 2021: Pays \$396K ($= 1/10 \times 39.6\% \times \10M)
- Pays \$396K each of next eight years, unless new losses/gains
- Prepays 90% (\$3.6M) of her capital gains taxes by 2029

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- Ultimate tax remains determined upon sale or death
- Gets refund over nine years if Apple price plummets

Example B: Bezos pays long-overdue tax

B. Bezos: \$200B in wealth and unrealized gains

- Pays \$8B ($= 1/10 \times 39.6\% \times \200B) each year 2021-2029
- Operates like a temporary 3.96% wealth tax but is an income tax: if he had no untaxed income, he'd pay no withholding

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Important: Withholding naturally taxes the very wealthy's \$8T of already accrued capital gains which generates enormous revenue

Example C: Entrepreneur pays via no-risk gov loan

C. Entrepreneur: Huge unrealized gains on a private startup

- Gov still gets 39.6% at sale. But for scoring, entrepreneur effectively pays in stock now despite no gov ownership.
- Technically: Entrepreneur receives gov loan backed by startup stock. Must use loan to pay IRS now in cash.
- JCT/CBO scores cash as revenue now and loan as NPV wash
- No risk: If startup fails, IRS refunds cash to repay the loan

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Unique feature: 100% of revenue is scored in ten-year window. A future repeal would be scored as enormous refund to ultra wealthy.

IRS can successfully administer withholding

Calculating tax due

- IRS estimates each rich taxpayer's stock of unrealized gains
- IRS maintains an ongoing record of the taxpayer's uncredited withholding amounts ("withholding account")
- Each year's withholding tax = 3.96% of the stock of unrealized gains, unless the withholding account exceeds 36% of the stock of unrealized gains (i.e., 90% of the total due)

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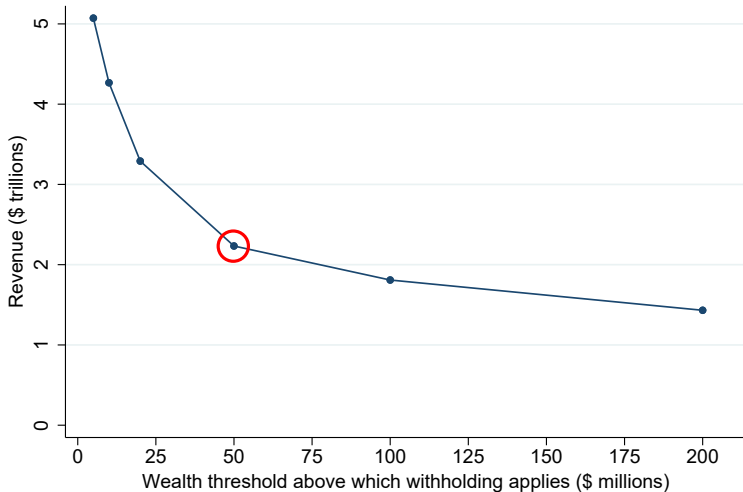
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Estimating the wealthy's stock of unrealized capital gains

- Liquid securities: Information returns with basis and value
- Illiquid securities: Formulas based on business tax returns

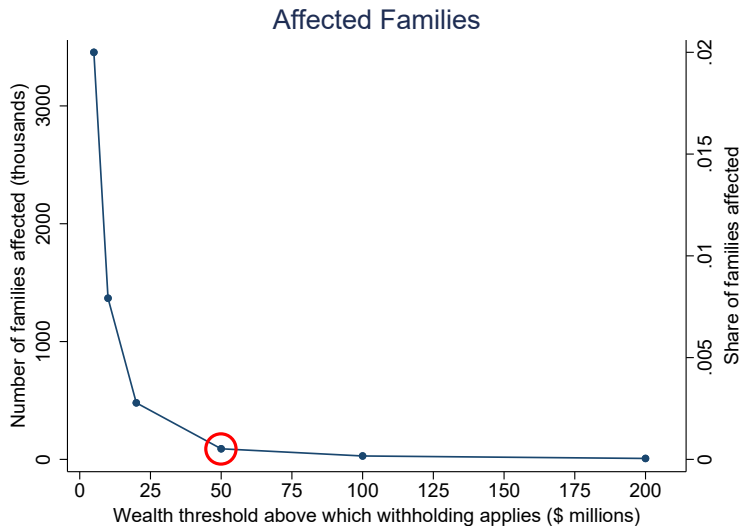
PWBM: Raises $> \$2T$ when applied only above $\$50M$ in wealth

Ten-Year Revenue Estimates



- Raises $\$2.23T$ under 39.6% rate (pictured). $\$2.08T$ under 23.8%.

...and affects only 90,000 families (the top 0.05%)



Other design choices should be made for political success

Explicit exemptions: Businesses with <\$50M in revenue?

Refunds and loss limitations: Offer nine-year refunds on overpayments with automatic audits, or only carryforwards?

Interest: Charges can compensate for over/under-payments

Divorce: Need rules for dividing withholding accounts

Capital gains withholding can help

Mark-to-market is close. Needs to be less scary and more robust.

1. Valuation uncertainty is smaller potatoes when ultimate tax liability remains determined at sale or death

2. Liquidity addressed by smoothed payments, no-risk gov loans

3. Robustness addressed by no-risk gov loans

Wealth thresholds and business revenue rules can categorically exempt almost everyone