VIEW CAPITAL
ADVISORS, LLC

Panorama

October 2019 ISSUE 33

Taxing Wealth in America

In this Issue:

This issue of Panorama is exclusively dedicated to a variety of perspectives surrounding the subject of "taxing wealth," a hot topic among all of the 2020 Democratic Primary candidates. The policy agenda advanced by those advocating a wealth tax is that income inequality in America is increasingly widening in favor of the top 1% of the American population. As a result, the progressive platform advances as fundamental human rights such items as universal healthcare, free college tuition and basic income for all to name a few. While the debate is intensifying among the body politic, the range of all of the arguments for and against these positions is beyond the scope of this newsletter.

Price tags that have been discussed for this vast increase in social programs are astronomical (in the trillions of dollars) and beg the question of how all of these programs can possibly be paid for? The national debt is just under $23 trillion and rapidly growing as of the writing of this article. Despite this, the candidates are undaunted by the price tags for these proposed expansive new programs. As with any question of financial funding, you either need more income or less expense, or both. So, what about reductions in government spending by politicians? This is probably unlikely, because politicians know that affected voters remember which politician took their money away when they go to the ballot box. For that reason alone, more revenue is the avenue of choice by the 2020 front runners. For the same reason that bank robbers rob banks, politicians seek to tax the rich because "that's where the money is."

No Billionaires?

My, how quickly times and opinions have changed! Socialism was a dirty word not that long ago. Senator Bernie Sanders recently tweeted that "there should be no billionaires. We are going to tax their extreme wealth and invest in working people." No, Sanders would not evict billionaires from the country, he would just reduce their wealth down to the levels of us common folk. Compare that tweet with President

Trump's tweet where he pledged that "America will never be a socialist country."

Polls show that while some Americans view billionaires with some suspicion, many people look at billionaires with admiration. There seems to be little support for seeking to eliminate billionaires entirely as a class of American, nor is there a large number of people who view the existence of billionaires as a policy failure by this country. That's the American dream, or so we've been told! This is an example of how dramatically the tide has changed on the subject of socialism versus capitalism just since the 2016 elections.

Integrity

Innovation

Character

Alternatives for Taxing Wealth

Understanding that there are widely held views by those opposing taxing wealth, either on policy or constitutionality grounds, let's simply explore possible wealth taxation avenues that could further the progressive policy agenda. Because of the magnitude of the government's need for revenue to cover the cost of these proposed programs and unwillingness to reduce spending, any approach must have significant scale to maximize the revenue impact.

Keep in mind that tax laws are simply rules. If the rule is not airtight, it may incentivize a taxpayer to engage in behaviors to legally reduce his exposure or avoid altogether the application of the rule. So when Warren Buffett proclaims that he "doesn't pay enough taxes," it is because he is following the advice of his highly paid tax advisors to pursue legal avenues to reduce his exposure to the array of taxes that would otherwise take a serious chunk of his wealth each year in taxes. Mr. Buffett, of course your secretary pays a higher tax rate on salary income than you pay because you choose to take dividends instead of salary since dividend rates are cheaper than the rates on earned income!

1. ***Dramatically increase the top tax rates on labor and investment income.*** Over two-thirds of the reported income of the top 1 percent is taxed at ordinary rates. Accordingly, a significant increase in the top ordinary rate can generate substantial revenues. Increasing the top individual rate from 37% to 70 percent on incomes over $10 million (the top 0.01 percent of households), as Rep. Ocasio-Cortez has suggested, would raise about $260 to $320 billion over ten years. The advantage of this approach is that those affected theoretically have the liquidity and resources available to pay the tab. On the other hand, higher tax rates create greater incentives for earners to change their behavior (like Buffett) to reduce taxes. Further increasing opportunities for tax avoidance would in turn render the tax system less efficient, more complex, and less fair.
2. ***Income tax accrued gains on investments and other assets at ordinary rates.*** Our current taxation regime only taxes gains when "realized." Taxing annual valuation increases that are only on paper would obviously raise significant tax revenues, and mostly from the wealthy. It would be also difficult to avoid such taxes through tax planning efforts currently available. Difficulties of this approach lie with the valuation process for illiquid assets. And, what goes up in value can go down in value which could substantially negatively affect the base for calculating this tax.
3. ***Wealth tax on high net worth individuals.*** The prime example of this is Senator Warren's proposed 2% annual tax on net worth over $50 million. As she explains, for every $1 of wealth over $50 million, an additional 2 cents of tax would be imposed on the excess. Sounds simple and painless! This tax would likewise raise a substantial amount of revenue. But since it is imposed on "value" and not "income," it inserts a complicated subjective determination that is bound to cause litigation nightmares for both taxpayers and the government. Some people might also begin to complain that the same wealth above the tax threshold that was taxed in prior years is taxed again each and every year. Or at least until it is gone!
4. ***Financial transactions tax.*** This avenue simply applies a transaction-related tax to the sale of financial assets. Unlike the income tax, it is not imposed on the gain on the asset sold, but on the full value of the asset when sold. While it would largely affect the wealthy, it would also impact foreigners who transact financial transactions in the U.S. Other major trading centers

such as the U.K. and Hong Kong impose such taxes. But, it is questionable how much revenue it would raise and whether it would impact trading volume and therefore market liquidity.

5. ***Limit the charitable deduction at death.*** So why is it that Bill Gates and Warren Buffett will pay no estate tax when they die? Because current tax law affords them an <u>unlimited</u> charitable deduction that offsets the taxable value of one's estate. And, being well-armed with sophisticated tax advisors, count on them using this tool. So if Jeff Bezos, Buffett and Gates all decide to leave their entire fortunes to the Gates Foundation when they pass, their estates will completely avoid estate taxation at 40% on hundreds of billions of dollars. Placing a cap on the maximum charitable deduction for ultra-wealthy individuals would raise significant revenue and put more revenue in the federal coffers. But you could count on objections to this idea by philanthropic lobbyists.
6. ***Tax consumption.*** Rather than taxing income, tax spending. Some might call this a national sales tax on goods and services purchased. A consumption tax doesn't penalize work, nor does it discriminate. Through a consumption tax, each taxpayer controls how much he spends and therefore limits how much is paid over to the Government on an annual basis. Moreover, it is fair – those who spend more pay more of the tax. Perhaps best of all, if a National sales tax is substituted for the current income tax, we would all be free from the burden of filing annual income tax returns!

Raising revenue will be a hotly debated subject in the coming elections. Educate yourself on the pluses and minuses of the various proposals and how it could impact you.

Perspective

Strength

Middle Class American Need Not Worry?

As the Mad Magazine mascot Alfred E. Neuman famously said – "What, me worry?" So unless you reside in that exclusive wealth club alongside of Zuckerberg, Buffett or Gates, most individuals who are reading (or writing) this newsletter have nothing to worry about with regard to the various wealth tax proposals. Or should they?

Let's review a taxation history lesson from the late 1960's. Then, as now, legislators were concerned that the wealthy were not paying their fair share of taxes due to their well-advised use of tax deductions and incentives (given by Congress) to lower or even eliminate their federal tax liability. Thus, the alternative minimum tax (AMT) came into being through Congressional legislation. Its mission was to ensure that all Americans paid a "minimum" level of tax regardless of their total income and their utilization of available deductions.

The AMT, which was enacted in 1969, was initially designed to target a few ultra-wealthy taxpayers who were entirely avoiding income taxes by legally claiming special deductions authorized by the Internal Revenue Code. Where the AMT applies, it acts as an add-on tax on some individuals, on top of their regularly computed income tax on income that was deemed to be "over sheltered" by the formulaic approach of the rule.

While the provision was originally targeted at roughly 150 Americans in 1969, the measure was never indexed for inflation. Therefore, the proportion of people who were required to pay AMT ballooned over time. Congress started to realize how much revenue they were getting and so the AMT has become a mainstay of tax policy for the past 50 years, so they conveniently sidestep the subject of inflation adjusting the exemption.

According to a congressional report, about 1 million people paid the AMT in 1999, while about 31 million did so in 2010 – which covered all but the very lowest income classes. Ask middle income taxpayers in high income tax states whether they pay AMT, if you dare. And you wonder why these taxpayers complain about the 2017 tax law change that limits their state income tax deductions to $10,000? So you should ask yourself if you feel safe from the application of any wealth tax proposals!

Can Warren's Tax Policy Accomplish Her Goal?

Capitalists are those who believe in an economic system that relies on the private ownership of capital assets and to spend or invest their money wherever they choose. The anticipated impact on capital growth by most measures around the globe is that a lower tax burden equates to growth in capital. And more capital means more investment, higher productivity and faster growing wages.

Senator Warren has made the fight against income inequality a centerpiece of her campaign. At odds are the desire for growth in the economy and capital, and the allocation of capital among all Americans. Most Democrats appear to be unified in reducing the trend and current levels of income inequality. Taxing wealth appears to be an overwhelmingly appealing method of taking "small amounts" annually from wealthy individuals and reallocating it to programs that benefit low and middle income Americans.

Senator Warren's view on wealth taxation is that it will only impact the ultra-wealthy, the proposed rate of taxation is virtually unnoticeable and correspondingly, the wealthy will not undertake tax reduction planning steps to reduce or avoid exposure to this tax and will pay it without objection. But capital is fickle and highly mobile. If capital is overtaxed, it will go elsewhere undermining growth.

According to the Tax Foundation, trends in the use of a wealth tax among other developed nations around the world don't reflect Senator Warren's enthusiasm for the concept. According to the OECD (Organization for Economic Cooperation and Development), of the 14 member countries who had a wealth tax in 1996, only Spain, Norway and Switzerland continue to have wealth taxes.

If a wealth tax makes so much sense, then why have so many other countries repealed theirs? Largely, this has been due to the small amount of money (relatively speaking) raised compared to the tremendous burden and cost of administering the tax.

Keep in mind that a wealth tax is imposed on the value of assets, not on a taxpayer's income. This is easy to compute when assets are comprised of cash and marketable securities. But when a taxpayer's net worth is largely derived from illiquid assets such as real estate and private companies, then "valuation" of that wealth becomes a major headache for all parties.

Taxpayers are apt to take the view that because their illiquid assets have no market, and would suffer a significant reduction if forced to fire sale the asset, then substantial valuation discounts are in order (as they are under current tax rules). The IRS on the other hand (who makes more revenue advocating higher values) argues just the opposite. When the two sides can't agree after both sides have spent considerable sums on valuation reports by independent appraisers, litigation ensues. Litigation is never cheap and there is nothing speedy about pushing a tax litigation matter through the normal venues, including possible appeals. Years may pass before a final court determination is made. From the IRS' perspective, they may spend more trying to determine the amount of tax than the revenue it receives from collecting the tax. And this exercise will happen each and every year on the same assets.

Even where both sides mutually agree or accept the court's determination of value, the assets may still be illiquid. One-thousand acres of land in the Mojave Desert may have an agreed "value" but not be readily saleable, even at fire sale prices. So does the taxpayer simply deed over a portion of that land to the IRS, wish them luck and mark their tax bill paid?

The only way to make the wealth tax work from the IRS perspective is with very high audit rates on the very rich. This means maybe one out of every two or three wealthy individuals would need to be audited annually to ensure proper compliance. However, the IRS ranks have shrunk in recent years as Congress has repeatedly cut the agency's budget. According to agency data, the IRS had 9,346 fewer examination and collection agents in 2018 than in 2010. This is a loss of more than 22% of the audit workforce including many seasoned examiners with the experience necessary to audit exceptionally wealthy people.

We will continue to follow developments on this important subject and keep our readers apprised.

Contributing to this issue:

R. Craig Brubaker

2727 N Harwood, Suite 225

Dallas, TX 75201

214-855-2550

www.view-cap.com

View Capital Advisors, LLC was founded in 2004 by its principals with the mission of providing sophisticated investment asset management and financial and estate planning to our U.S. and Non-U.S. clients.

We seek to bring wealth planning best practices and a wide range of non-proprietary solutions to our clients. We also conduct our own research and diligence on world markets and investment alternatives.

For further information, please contact your investment representative or one of our wealth planning specialists:

R. Craig Brubaker 214-855-2556
cbrubaker@view-cap.com

VIEW CAPITAL
ADVISORS, LLC