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Not So Fast: The Hidden Difficulties of Taxing Wealth

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NOT SO FAST: THE HIDDEN DIFFICULTIES OF TAXING WEALTH

NOMOS WEALTH VOLUME

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As an antidote to increasing inequality, policymakers and academics frequently call for heavier taxes on the wealthy. To those outside the tax academy, proposals such as increasing marginal rates, implementing a wealth tax, or strengthening the estate tax likely sound like variations on the same theme. Many discussions of using the tax system to fight inequality therefore ignore differences among tax instruments. As this Essay shows, using the tax system to fight inequality requires careful consideration of both normative and practical concerns. Certain goals (for example, the concern that wealth concentrations harm the political and economic systems) suggest taxing wealth itself via an annual wealth tax as an ideal solution. Not only would such a tax be hobbled by administrative and valuation concerns, however, it is likely unconstitutional. The optimal second-best solution would be to tax capital gains at death, thereby closing the loophole that allows untaxed appreciation at death forever to escape taxation. In contrast, other goals (such as equality of opportunity) counsel taxing wealth transfers as an ideal matter. Best reflecting that goal is an accessions tax that taxes transferees on the cumulative amount of gifts and bequests received. One unintended consequence of wealth transfer taxes, however, is that they likely spur families to engage in greater consumption, much of which may exacerbate inequality of opportunity. This consequence means that taxation must also be coupled with greater leveling up efforts that provide children born to less-financially advantaged families with opportunities to develop their talents and abilities.

INTRODUCTION

Rising inequality has attracted immense political and academic attention in recent years, due in large part to Thomas Piketty's CAPITAL IN THE TWENTY-FIRST CENTURY.[1] As an antidote to increasing inequality, commentators have suggested solutions ranging from making the income tax system more progressive to strengthening the estate tax to implementing an annual wealth tax. To academics in fields other than tax, these proposals likely sound like variations on the same theme: taxing the well-off more heavily. To that end, most discussions of

*Professor of Law, The University of San Diego. I would like to thank Jordan Barry, Noel Cunningham, Victor Fleischer, Dov Fox, Jack Knight, Jim Repetti, Melissa Schwartzberg, Dan Shaviro, Mila Sohoni, and Larry Zelenak for valuable feedback, as well as participants in the Boston College Law School Tax Policy Workshop and the UCLA Law School Colloquium on Tax Policy and Public Finance. I also thank Ana Menshikova for helpful research assistance.

[1] THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (2014).

minimizing inequality that occur outside the tax academy ignore the very real differences among tax instruments.[2]

This lack of attention is unfortunate. On a theoretical level, these structures represent divergent value judgments about what counts as inequality and why it matters, which influences one's choice of solutions in an ideal world. Consider wealth inequality. Instituting a more progressive consumption tax in lieu of taxing wealth or wealth transfers reflects a view that invested wealth is not problematic, but that consumed wealth is. An annual wealth tax implies that allowing individuals to accumulate large amounts of wealth in and of itself harms society. Estate and accessions taxes suggest that wealth per se is not problematic, but that its intergenerational transfer detrimentally impacts society. Even choosing between an estate tax (which taxes the total amount of wealth gratuitously transferred away by a decedent) and an accessions tax (which taxes the total amount of gratuitous transfers received by an individual) implies different things about what problems intergenerational wealth transfers create.

On a practical level, tax instruments vary drastically in terms of administrative considerations. Not only is an annual wealth tax susceptible to constitutional challenges, for example, but such a tax would be hobbled by valuation issues. On the other hand, certain income tax reforms – such as taxing capital gains at death – are more easily administrable and less politically divisive. Taxing wealth transfers has its own challenges. Namely, the current scheme poorly reflects its most common justifications and has unintended consequences that exacerbate inequality of opportunity.

These theoretical and practical differences among tax instruments mean that attacking inequality requires more than simply trying to increase taxes on the well-off, regardless of how that is accomplished. Instead, deciding whether and how to use taxes to fight inequality requires a nuanced consideration of the practical and theoretical differences among tax instruments, coupled with a more specific identification of what is meant by inequality, what causes it, and what harm it allegedly produces. Is inequality of income, wealth, or consumption the main problem? Is the concern the inequality between the very wealthiest (the top 1% or .1%) and everyone else, or between everyone else and some other group (such as the top 10% or 20%)? Do differences in human capital cause inequality, or something else? Is the harm unequal opportunities and a lack of social

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[2] Welcome exceptions in the tax literature include Anne L. Alstott, *Equal Opportunity and Inheritance Taxation*, 121 HARV. L. REV. 469 (2007); Joseph Bankman & Daniel Shaviro, *Piketty in America: A Tale of Two Literatures*, 68 TAX L. REV. 453 (2015); Lily L. Batchelder, *What Should Society Expect From Heirs? The Case for a Comprehensive Inheritance Tax*, 63 TAX L. REV. 1 (2009); Edward McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L. J. 283 (1994); Eric M. Zolt, *Inequality in America: Challenges for Tax and Spending Policies*, 66 TAX L. REV. 641 (2013).

mobility? Unequal political influence? Discomfort with the absolute standard of living for those on the bottom? Or another concern entirely?[3]

To that end, this Essay examines three of the most common justifications for taxing wealth to fight inequality and identifies which, if any, tax instruments can address those concerns. These three arguments are (1) ignoring wealth when determining one's ability to pay taxes treats taxpayers unequally, resulting in wealthy taxpayers (however defined) not paying their fair share while overburdening the non-wealthy ("ability to pay"); (2) wealth concentrations harm the democratic system and stunt economic growth ("wealth concentrations as per se harmful"); and (3) intergenerational transfers of wealth impede equality of opportunity ("equality of opportunity"). Although the merits of these arguments are hotly contested, this Essay sidesteps those debates. Instead, it takes as given the desire to use the tax system to address those concerns and discusses the normative and practical considerations relevant to so doing.

As this analysis shows, one's underlying normative goal will determine the first-best policy instrument. In several cases, however, practical considerations relating to valuation, administrability, and behavioral responses render first-best choices largely ineffective. In some instances, second-best instruments may offer at least a partial solution. At other times, even second-best solutions may be futile. Taxing wealth more heavily is extremely difficult. Attempts to do so often have little more than symbolic value, and at times create behavioral responses that may worsen the underlying problem. In these cases, policymakers would often be better served by focusing on non-tax approaches to fighting inequality, such as improving opportunities for children born to poor families to develop their talents and abilities fully.

Unfortunately, a full exploration of all the considerations relevant to taxing wealth and wealth transfers is beyond the scope of an Essay of this length. First, this Essay does not explore whether wealth, income, or consumption is the optimal base if one's goal is simply to raise revenue. A deep body of scholarship discusses which base – and which methods of taxing each – generates the most revenue with the fewest economic distortions. Along these lines, some readers may support taxing the wealthy out of concern about the absolute standard of living of those at the bottom. This aim, however, relates more to fighting poverty (rather than inequality per se), a goal that raises its own set of questions about the optimal way to raise revenue to fund anti-poverty programs and what tax policies should apply to those at the bottom.[4]

[3] For a discussion of these questions in conjunction with CAPITAL IN THE TWENTY-FIRST CENTURY, *see* Liam Murphy, *Why Does Inequality Matter? Reflections on the Political Morality of Piketty's Capital in the Twenty-First Century*, 68 TAX L. REV. 613 (2015).

[4] *See* David Kamin, *Reducing Poverty, Not Inequality: What Changes in the Tax System Can Achieve*, 66 TAX L. REV. 593 (2013).

Instead, this Essay assumes that there is something about wealth itself – other than its revenue-raising capacity – that renders taxing wealth (or its transfer) desirable. That said, this Essay takes no position on whether the wealth of the top .1%, top 1%, or top 10 or 20% is the problem. This is so because the different justifications for taxing wealth suggest different focal points. Contrast the fear that large wealth concentrations damage the political or economic system with equality of opportunity concerns. Law firm partners – and even law professors – can provide advantages to their children that may exacerbate inequality of opportunity. But their wealth – such as it is – has little impact on the political and economic system, in contrast to the wealth of individuals like Michael Bloomberg, Mark Zuckerberg, and Bill Gates.

Nor does this Essay address the broader macro-economic impact of the proposals discussed below. In the real world, policymakers will need to address the extent to which these proposals impact economic growth and whether any such effects outweigh the egalitarian policies they are pursuing. Lastly, this Essay generally also ignores the political difficulties that would surround any of these proposals. Public discourse is hotly divided between the anti-tax right and the pro-tax left; the tax plans of the leading presidential contenders reflect this deep divide. That said, certain of the reforms discussed herein have been endorsed – across the political spectrum – by academics and policymakers removed from the political fray. Generally, these proposals – such as taxing capital gains at death – can be recast as closing loopholes instead of raising taxes, thereby making them more politically palatable.

This Essay proceeds as follows. Part I briefly describes current law and the most commonly-mentioned reform proposals for taxing the wealthy more heavily. Part II reviews the most common normative justifications for taxing wealth. Part III explores which of these justifications call for a wealth tax as a first-best solution, addresses the normative and practical concerns that accompany a wealth tax, and concludes that income tax reforms such as taxing capital gains at death are more viable second-best options. Part IV demonstrates how the equality of opportunity concerns triggered by wealth transfers favor an accessions tax over an estate tax as an ideal matter, discusses the complexities that render leveling down difficult and the necessity of leveling up, and concludes by arguing that funding leveling up policies does not necessarily entail taxing the wealthy. Part V concludes.

I. TAXING THE WEALTHY

Before exploring which tax instruments are best poised to combat various forms of inequality, it is useful to briefly review a few key features of our current tax system and the most-discussed reforms for taxing the wealthy (however defined) more heavily.

A. Current Law

The public tends to focus on income tax rates and the availability of deductions as indicators of how heavily the wealthy are taxed. Although rates (which currently top out at 39.6% for ordinary income) and deductions are not totally irrelevant, they are less important than a variety of other structural elements in our income, estate, and gift tax systems.

1. The Income Tax

With respect to the income tax system, the treatment of capital income (in contrast to ordinary income from labor and other non-investment sources) heavily influences the extent to which the wealthy are taxed. Here, the realization requirement (which requires a sale or disposition to trigger tax), basis rules (which govern the purchase price used to calculate gain or loss from property transactions), and preferential rate treatment (which taxes capital income at a lower rate than other income) play key roles.

Simplifying a bit, the realization requirement holds that mere increases in value do not constitute taxable income. Suppose that *Alice* buys stock for $100 that increases in value over the course of a year to $450. Theoretically, *Alice* is better off by $350 than she was before, just as if she had received $350 as wages from her employer. A theoretically pure income tax system would tax *Alice* on that increase in value.[5] Largely due to valuation and liquidity concerns, however, our income tax system does not tax *Alice* until she sells or exchanges her stock. Estimates suggest that for the top income decile, unrealized appreciation accounts for almost 40% of these taxpayers' assets.[6]

What happens if *Alice* gifts or bequeaths her appreciated stock to *Ben*? Under current law, neither transaction is treated as a realization event, meaning that neither event creates any income tax consequences to *Alice*. Nor does receiving the stock count as income to *Ben.* Later sales by *Ben*, however, may trigger tax. If *Alice* makes a lifetime transfer of the stock to *Ben* when it is worth $450, he uses her purchase price as his basis to calculate gain when he later sells (known as "carry-over basis").[7] If *Ben* later sells the stock for $500, for example, he will owe taxes on a gain of $400 (his $500 sales price less *Alice's* $100 purchase price).

If *Alice* instead bequeaths the stock to *Ben*, however, he uses its fair market value at her death as his basis to calculate gain when he later sells (known as

[5] *See* Deborah H. Schenk, *A Positive Account of the Realization Rule*, 57 TAX L. REV. 355, 357-58 (2004).
[6] Brian K. Bucks et al., *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, Fed. Res. Bull. A1, A36 (2009).
[7] I.R.C. § 1015.

"stepped-up basis").[8] If the stock's value at her death is $450 and *Ben* sells for $500, he will owe taxes on a gain of only $50. The $350 increase in value in *Alice's* hands is never taxed. One can therefore avoid income taxes on a great deal of capital appreciation simply by holding onto appreciated assets until death. Unrealized appreciation comprises a large portion of the estates of wealthy decedents: An average of 33 to 36% of estates between $5 million and $50 million, and 46% of the value of estates over $50 million.[9]

Nor is borrowing treated as a realization event, which allows taxpayers to borrow against the value of appreciated assets without triggering any tax liability. Assume that instead of transferring the stock to *Ben*, *Alice* instead holds it and uses it as collateral for a $350 loan. If she defers repayment until her death, her estate can liquidate the stock free of tax and use the proceeds, undiminished by tax, to repay the loan (the liquidation is tax-free due to the stepped-up basis rule). In this manner, *Alice* benefits from the increase in value without ever paying income tax on that increase.

Lastly, a preferential tax rate also applies to capital income: 23.8% (including a 3.8% surtax on investment income) as opposed to a top marginal rate of 39.6% on labor and other ordinary income above $415,050.[10] Not surprisingly, this difference encourages taxpayers to convert what would otherwise be ordinary income into capital income. Many investment fund managers, for example, are able to characterize as capital income the profits interest that they receive for their management services.[11] Data suggests that for the .5% of highest-income taxpayers, realized capital gains exceed 20% of their incomes, and in 2010, households in the top 1% of the income distribution accounted for almost 70% of realized capital gains.[12]

2. The Estate and Gift Taxes

Extremely wealthy individuals face not only the income tax but also the estate and gift taxes, which are excise taxes on the transfer of wealth. Together, these taxes tax individuals who make cumulative transfers of over $5,450,000 at a rate of 40%, regardless of whether the transfers are lifetime gifts or testamentary bequests.[13] *Alice*, who makes a $6,000,000 lifetime gift to her son, is taxed at a

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[8] I.R.C. § 1014.

[9] Robert B. Avery et al, *Death and Taxes: An Evaluation of the Impact of Prospective Policies for Taxing Wealth at the Time of Death* 68 Nat'l Tax J. 601, 617 fig.1 (2015).

[10] This sum represents the point at which the highest marginal rate begins in 2016 for unmarried individuals; it is adjusted for inflation annually.

[11] Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1 (2008).

[12] Deborah H. Schenk, *The Luke Effect and Federal Taxation: A Commentary on McMahon's The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 1129, 1130 (2004); Tax Policy Center, Distribution of Long-Term Capital Gains, T09-0490 (Dec. 11, 2009), http://www.taxpolicycenter.org/numbers/Content/PDF/T09-0490.pdf.

[13] I.R.C. §§ 2001; 2010; 2501; 2505. The exemption amount is indexed for inflation annually.

rate of 40% on the excess of her transfer over $5,450,000. So is *Ben*, who leaves a $6,000,000 bequest in his will to his daughter. *Chloe*, who makes a $3,000,000 lifetime gift to her son in addition to leaving him a $3,000,000 bequest, is also taxed at 40% once her total transfers exceed $5,450,000.[14] Estimates suggest that for 2015, only 2 out of every 1,000 decedents will be subject to the estate tax.[15]

Because the estate and gift taxes focus on the total amount of wealth transferred out by a decedent, they generally ignore the identity of the recipient. Transfers to spouses and charities, however, are usually free of tax, while transfers to grandchildren and younger generations face an additional tax. This generation-skipping transfer tax is designed to reflect an ideal that estate or gift tax should be imposed every generation, and that transferors who make transfers directly to their grandchildren (instead of to their children who later make transfers to the grandchildren) are there by "skipping" a level of tax. Each individual has a $5,450,000 lifetime generation-skipping tax exemption in addition to their gift and estate tax exemption.[16]

In addition to these lifetime exemptions, taxpayers may also use the annual exclusion to gift substantial assets free of transfer tax. The annual exclusion allows each taxpayer to give $14,000 per recipient per year to as many individuals as she likes, without these transfers counting toward her lifetime exemption amount.[17] *Alice*, for example, can give her five children and their spouses each $14,000 a year -- $140,000 total – without eating into her exemption amount. If she makes these gifts for, say, twenty years, she is able to transfer wealth of $2,800,000 without paying any gift, estate or generation-skipping tax. *Alice*'s spouse also has his or her own annual exclusion, and can also gift the same recipients $14,000 a year each. In some cases, the annual exclusion allows taxpayers to establish substantial trusts free of tax; although beneficiaries may owe income tax on distributions, no gift or estate tax would be triggered.

Readers have likely heard the popular critique that the estate and gift taxes "double-tax" assets that have already been taxed under the income tax system. This critique is only true to the extent that one's wealth comes from salary or other ordinary income items or from realized capital gains; the step-up in basis

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[14] The main difference between the tax treatment of gifts and bequests concerns whether the funds used to pay the tax are considered part of the transfer (and therefore part of the tax base). To illustrate, imagine that *Anna* has used up her exemption amount and makes a taxable gift of $1,000,000. Because the gift tax is tax-exclusive, she will pay the $400,000 tax out of her own pocket, and the donee will receive the entire $1,000,000. In contrast, the estate tax is tax-inclusive, meaning the funds used to pay the tax are considered part of the transfer. If she dies with a taxable estate of $1,000,000 (after using her exemption amount), her estate will pay the $400,000 tax from that sum and her heirs will only receive $600,000. This parallels the tax-inclusive nature of the income tax: we pay income tax out of the funds used to calculate our taxable income.

[15] Joint Committee on Taxation, *History, Present Law, and Analysis of the Federal Wealth Transfer Tax System* 29, 30 (JCX-52-15), March 16, 2015.

[16] I.R.C. §§ 2601; 2631. This amount is also indexed for inflation.

[17] This amount is also indexed for inflation.

described in Section II.A means that untaxed capital appreciation in one's estate is never taxed under the income tax system. Given the $5,450,000 transfer tax exemption, much of this appreciation also remains untaxed under the estate and gift tax.

B. Instruments for Taxing the Wealthy More Heavily

Assuming that one finds the current tax treatment of the wealthy insufficient, a variety of reforms could theoretically tax them more heavily.[18] Building on our current system, we could change the income tax treatment of the wealthy by raising rates on ordinary income, removing the capital gains preference, completely or partially repealing the realization requirement, expanding minimum tax requirements, replacing stepped-up basis with carry-over basis, or making death a realization event. We could also strengthen existing estate and gift taxes by raising rates, lowering the exemption amount, or closing loopholes; or strengthen the corporate income tax.

Other instruments are a departure from current practice. For example, we could impose a federal wealth tax, just as states and municipalities impose property taxes on real property. Alternatively, we could replace the existing transfer tax system with some type of inheritance or accessions tax, which focuses on amounts received by donees. Lastly, as Ed McCaffery suggests, we could abandon the effort to tax wealth and instead institute a highly progressive consumption tax.[19]

II. WHY TAX THE WEALTHY?

Which of the foregoing options – if any – that one chooses will reflect one's motivation for taxing the wealthy, coupled with an understanding of the practical difficulties of so doing. One common purpose is simply to raise revenue, and wealthy taxpayers have the most money. Other times, the desire to tax the wealthy stems from concern about the absolute standard of living of those at the bottom. This goal, however, is more about fighting poverty (which requires raising revenue and implementing other tax policies that aid the poor) than inequality per se.

In these cases, choosing one instrument over another to raise revenue will not reflect any normative judgments concerning the source or use of one's income or wealth. Policymakers could therefore ignore the theoretical underpinnings of the available policy options and instead focus solely on their revenue-raising consequences. If taxpayer behavior remained constant, how much revenue could theoretically be raised and at what administrative cost? What avoidance

[18] *See* David Kamin, *How to Tax the Rich*, TAX NOTES 119 (January 5, 2015) (providing a useful overview of these options); Bankman & Shaviro *supra* note 2, at 504-11 (discussing various possibilities for taxing the returns to human capital more heavily).
[19] McCaffery, *supra* note 2.

mechanisms might taxpayers dream up? Would behavioral responses create unintended consequences that dampen economic growth and decrease overall tax revenues in the future? Such is largely the goal of the optimal tax literature.

As explored in more detail below, however, social goals other than revenue frequently motivate proposals to tax the wealthy more heavily. In those cases, one's purpose for taxing wealth will influence the choice of first-best structure. Given our non-ideal world, however, practical and administrative considerations also impact various tax instruments' abilities to achieve a given normative goal. Policymakers must therefore consider both theoretical and practical differences among tax instruments when deciding whether and if so, how, to use tax as a tool for achieving their aims.

Why might one wish to tax the wealthy more heavily? Recent calls for higher taxes on the wealthy generally invoke rising wealth and income inequality. As an initial matter, it is frequently unclear which of wealth inequality and income inequality is the concern. Although the two are often related, some wealthy individuals have little current income, and some high-income individuals have a low net worth. Take *Dov*, a first-generation immigrant who is now a lawyer at a New York law firm, drawing a high six-figure salary. *Dov* supports his wife, four children, and his parents on his salary. Because he needs to repay student loans and live within a reasonable commute of New York City in a house large enough for 8 people, his expenses eat up much of his salary and his mortgage offsets much of his housing value. Compare *Dov* with *Elese*, whose grandparents founded a successful hotel chain. *Elese* is the beneficiary of a substantial trust fund. She lives in a penthouse purchased for her by her parents, has no student or other debt, and finances a lavish lifestyle via the trust fund. Although *Elese* has substantial wealth, her income is relatively low. From the standpoint of equality, who is the problem, *Dov* or *Elese*?

Let's assume, given this volume's topic, that the wealth inequality exemplified by *Elese* is the problem. Unfortunately, many discussions of wealth inequality assume that the fact of inequality demonstrates its moral harm and do not specifically identify what harm flows from wealth inequality as such.[20] Other commentators frequently conflate a variety of justifications that in reality are conceptually distinct.[21] When one looks closely, however, three general justifications for taxing wealth to fight inequality (other than raising revenue) predominate.

1. *Ability to Pay.* One common motivation for increasing taxes on the wealthy is to improve the fairness of the tax system by better tying one's tax

[20] *See, e.g.*, Bankman & Shaviro, *supra* note 2, at 455 (noting that "Piketty does not entirely specify exactly what is wrong with rising high-end wealth concentration"); Murphy, *supra* note 3, at 629 (also critiquing the view that wealth inequality is prima facie morally harmful).
[21] *See, e.g.*, Alstott, *supra* note 2, at 471 (arguing that scholarship often conflates equality of opportunity ideals with goals that are distinct from such ideals).

burden to one's ability to pay.[22] Underlying this justification is the intuition that one's realized income often understates one's ability to pay taxes and that one's net worth should also be considered. Consider Facebook founder Mark Zuckerberg, whose net worth is an estimated $37.7 billion but whose taxable compensation income, including his $1 salary, was roughly $600,000 in 2014.[23]

Many observers look at Zuckerberg and others with relatively low incomes but much wealth – including trust fund children such as Paris Hilton – and argue that taxing only their income understates their ability to pay and as a result, they do not bear their fair share of the collective tax burden. This stems from the tax policy concept of horizontal equity, generally meaning that similarly-situated individuals should face similar tax bills. Looking only at Mark Zuckerberg's income suggests that his ability to pay is comparable to that of a junior partner at a law firm, which clearly isn't the case. Broadening the tax base to include one's wealth, these commentators argue, would better tie one's tax burden to one's ability to pay. In contrast, not taxing wealth allows the wealthy to pay less than their fair share while simultaneously overburdening the non-wealthy.

2. *Large Wealth Concentrations Damage Democracy and Hinder the Economy*. A second common justification for taxing the wealthy more heavily is that large wealth accumulations impede democratic functioning and economic growth. Under these views, taxing wealth is akin to taxing carbon: both are examples of Pigouvian taxes that seek to minimize negative externalities by taxing the activity generating the externality.[24]

First consider the democratic argument.[25] Jim Repetti has outlined the myriad ways that wealth gives one opportunities to influence the political process.[26] One can influence the media's news and editorial coverage by owning media outlets directly (witness Rupert Murdoch), or by buying or refusing to buy advertising. The wealthy have a greater ability to make substantial, albeit limited

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[22] *See, e.g.* Batchelder, *supra* note 2; Murphy, *supra* note 3, at 628; David Shakow & Reed Shuldiner, *A Comprehensive Wealth Tax*, 53 TAX L. REV. 499 (2000).
[23] U.S. Executive Compensation Database: Mark Zuckerberg, Morningstar, Inc., LEXIS (2016); Rachel Gillett, *Mark Zuckerberg Reveals Why He Only Makes $1 a Year*, business insider.com (June 30, 2015). Unfortunately, data concerning Zuckerberg's 2014 investment income, in 2014, if any, was unavailable. It is likely, however, that any such income is relatively small. In 2012, Zuckerberg exercised stock options that allowed him to purchase 60 million Facebook shares then trading at $42 a share for a mere 6 cents each. These transactions did generate substantial taxable compensation income, creating a hefty billion-dollar tax bill for Zuckerberg in 2012. The realization requirement, however, means that any future increase in value is not taxable to Zuckerberg unless and until he sells his shares. There seems to be little reason for Zuckerberg to do so, given that he can borrow against them to obtain liquid funds tax-free. And if he dies holding those shares, that appreciation will never be taxed under the income tax system. Edward J. McCaffery, *Zuck Never Has to Pay Taxes Again*, available at: cnn.com (April 9, 2013).
[24] *See* Bankman & Shaviro, *supra* note 2, at 455, 471-72, 511.
[25] *See, e.g.*, James R. Repetti, *Democracy, Taxes and Wealth*, 76 N.Y.U. L. Rev. 825 (2001); Eric Rakowski, *Can Wealth Taxes Be Justified?*, 53 Tax L. Rev. 263, 291-94 (2000) (describing and critiquing this justification).
[26] *See* Repetti, *supra* note 25, at 841-49.

contributions directly to candidates, parties, and political committees. They can also make unlimited contributions to § 501(c)(4) organizations that engage in some campaign intervention activities and unlimited lobbying and issue advocacy, which allows them to place certain issues on the political agenda. Wealthy individuals often enjoy greater access to elected officials already in office,[27] and can more easily run for office themselves.[28] Wealth also gives its holder indirect influence. Elected officials often consult economic leaders not only for economic advice, but also for noneconomic advice in order to protect jobs in their areas.[29] Lastly, business leaders often become civic leaders, shaping the goals and priorities of a community from the ground up.

The second alleged externality from large wealth accumulations is their negative impact on economic growth. Several studies show, for example, a large correlation between high income concentration (about which more data exists than wealth concentration) and low economic growth.[30] Although a number of possible explanations exist, two seem most likely. First, high amounts of income inequality may lead to underinvestment in education on two levels: poor families are less able to invest in education, and upper-income families are less willing to support policies that advance educational opportunities for the poor. Secondly, social instability associated with high inequality may deter economic growth.[31]

3. *Combatting Dynastic Wealth (Usually an Awkward Way of Saying Equality of Opportunity).* A final common justification for taxing wealth – or, more precisely, for taxing the transfer of wealth – is to prevent "dynastic wealth." What exactly that is and why it is bad, however, is somewhat unclear. Some commentators argue that wealth transfers should be taxed to impede the accumulation of wealth, equating the build-up of wealth within families with wealth accumulation as such and ascribing to both the same political and economic harms.[32] Because these arguments mirror those just described, I shall

[27] *Id.*, *see also* Miranda Perry Fleischer, *Charitable Contributions in an Ideal Estate Tax*, 60 TAX L. REV. 263, 278-79 (2007). Recent comments by Republican Presidential candidate Donald Trump illustrate the effect of large contributions. When asked why he made a number of contributions to Democratic candidates, he answered that "I give to everybody. When they call, I give. And you know what, when I need something from them two years later, three years later, I call them. They are there for me." Jill Ornitz and Ryan Struyk, *Donald Trump's Surprisingly Honest Lessons About Big Money in Politics*, ABC News (Aug. 11, 2015) available at http://abcnews.go.com/Politics/donald-trumps-surprisingly-honest-lessons-big-money-politics/story?id=32993736.
[28] Witness Donald Trump, Michael Bloomberg, and Ross Perot.
[29] *See* Fleischer, *supra* note 27, at 279 n. 75. After public outcry from a number of large corporations, for example, Arizona governor Jan Brewer vetoed a bill that would have protected the right of religious business owners to refuse service to same-sex couples. Cindy Carcamo, *Arizona Gov. Jan Brewer Vetoes So-Called Anti-Gay Bill*, L.A. TIMES (Feb. 26, 2014).
[30] *See* Repetti, *supra* note 25, at 832-35 (collecting studies).
[31] *Id.* at 838-40.
[32] *See e.g.*, Repetti, *supra* note 25; William D. Andrews, *Reporter's Study of the Accessions Tax Proposal* § A2, *in* AM. LAW INST., FEDERAL ESTATE AND GIFT TAXATION 446, 460-68, 475 (1969); David G. Duff, *Taxing Inherited Wealth: A Philosophical Argument*, 6 CAN. J. L. & JUR. 3, 19-20, 25-26 (1993).

not address them again. As I shall discuss momentarily, this concern calls for a tax on wealth itself, not a tax on the transfer of wealth, as a first-best solution.

Other scholars, however, identify harms specifically related to the transfer of wealth, as distinct from its concentration or possession. The most common of these reflects *ex ante* equality of opportunity ideals, meaning that the chance circumstances of one's birth should not govern life outcomes. Instead, one's choices and abilities should determine success in life, and divergent outcomes due to choice, but not chance, are tolerated.[33] In tax scholarship, the interpretation of these ideals known as resource egalitarianism predominates.

Under this view, the ability of some parents but not others to pass along financial advantages to their children upsets equality of opportunity. This is so because individuals born to families of differing financial circumstances have varying opportunities to develop fully their talents and pursue their visions of the good life. Some parents pay for tutors, expensive music lessons, and sports camps; others cannot. Some children participate in prestigious internships arranged by their parents or take educational trips to Europe during the summer; others must work one or more jobs to help pay the rent. Wealth transfer taxation, the reasoning goes, is appropriate to level the playing field so that one's education, occupation, and social class are not determined by the chance circumstance of being born into a rich or poor family.

A final, albeit less common, justification for minimizing large inter-generational wealth transfers stems from an aversion to hereditary economic and political power. Recall the myriad ways wealth translates into political influence. Regardless of one's opinion about the effects of earned wealth on democracy, being able to transfer political power and influence to one's heirs is antithetical to this country's democratic ideals.[34]

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The above-mentioned arguments are, of course, hotly contested.[35] For example, the optimal tax literature largely suggests that consumption is the best measure of ability to pay, given that income and wealth taxes burden later consumption more heavily than immediate consumption without any normative justification for so doing.[36] Other literature contests the validity of the alleged harms discussed above. Some scholars argue, for example, that heavy political spending does not in fact impact the democratic process, or that large wealth

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[33] *See, e.g.*, Alstott, *supra* note 2; Duff, *supra* note 32, at 45; Miranda Perry Fleischer, *Equality of Opportunity and the Charitable Tax Subsidies*, 91 B. U. L. Rev. 601 (2011).
[34] *See* Miranda Perry Fleischer, *Divide and Conquer: Using an Accessions Tax to Fight Dynastic Wealth*, 57 B. C. L. REV. ___ (forthcoming 2016).
[35] *See, e.g.*, Joseph M. Dodge, *Replacing the Estate Tax with a Reimagined Accessions Tax*, 60 HASTINGS L. J. 997, 1003-04 (2009); Duff, *supra* note 32, at 58-62; Rakowski, *supra* note 25, at 264-66.
[36] *See, e.g.*, Bankman & Shaviro, *supra* note 2.

concentrations are merely correlated with, not a cause of, poor macro-economic performance.[37] Others dispute the resource egalitarian interpretation of equality of opportunity ideals, or argue that addressing inequality is beyond the proper role of government.[38] Lastly, some argue that wealth that is invested, instead of used to finance personal consumption, is being put to productive use and therefore should remain untaxed.[39] This Essay sets those debates aside. It takes as a given the desire to use the tax system to fight wealth inequality and instead focuses on designing tax instruments to do so.

Of the foregoing concerns, the first and second suggest that taxing wealth itself via a wealth tax is a first-best solution. The third, however, implies that taxing the inter-generational transfer of wealth is the ideal solution. Of course, minimizing wealth accumulations in the hands of a given individual (as a wealth tax does) necessarily limits his or her ability to transfer wealth to his or her heirs. Likewise, restricting a given individual's ability to transfer wealth to his or her heirs necessarily limits the ability of those heirs to accumulate their own wealth.

Choosing either a wealth tax or a wealth transfer tax as a first-best solution, however, signifies what one views to be the more pressing problem – wealth accumulations themselves, or their transfer. Even when practical or other considerations render first-best instruments unworkable, working from a theoretically pure starting point leads to better second-best solutions. The remainder of this Essay examines the first-best solutions suggested by the justifications for taxing wealth discussed above, along with various practical ramifications of those instruments.

III. TAXING WEALTH ITSELF

Of the foregoing arguments for taxing wealth, the ability-to-pay concern and the argument that large wealth concentrations negatively impact the political and economic systems each call for taxing wealth itself as an ideal solution. This contrasts with taxing wealth transfers and with strengthening income taxes. Taxing only the transfer of wealth leaves it untouched in the hands of its initial owner, thereby neither reflecting his or her ability to pay nor directly combatting any political or economic ills associated with wealth inequality. And even though

[37] *See, e.g.*, Stephen J. Dubner, *How Much Does Campaign Spending Influence the Election? A Freakonomics Quorum* (Jan. 17, 2012, 7:40 AM), http://freakonomics.com/2012/01/17/how-much-does-campaign-spending-influence-the-election-a-freakonomics-quorum/ (discussing whether campaign spending affects electoral outcomes); JARED BERNSTEIN, CENTER OF AMERICAN PROGRESS, THE IMPACT OF INEQUALITY ON GROWTH 1-3 (Dec. 2013), https://www.americanprogress.org/wp-content/uploads/2013/12/BerensteinInequality.pdf (noting that proof of inequality's impact on growth is elusive).

[38] *See, e.g.*, JOHN RAWLS, A THEORY OF JUSTICE 65-75 (Harvard University Press 1971) (comparing careers open to talents with resource egalitarianism, which he terms "fair equality of opportunity"); HARRY G. FRANKFURT, ON INEQUALITY 68-71 (Princeton Univ. Press 2015); ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 235-38 (Basic Books 1974).

[39] Edward J. McCaffery, *The Meaning of Capital in the Twenty-First Century*, 4, 12, 15-18 (forthcoming, on file with author).

an income tax is economically equivalent to a wealth tax in certain circumstances,[40] strengthening income taxes sends a political signal that income, not wealth, inequality is the problem.

This section begins by addressing what wealth taxes designed to reflect either the ability-to-pay or negative externality concerns would look like. It then discusses the practical considerations that likely render such taxes unworkable in the real world, and explores second-best alternatives.

A. An Ideal Wealth Tax

The theoretically best way to tax wealth as such is to impose an annual wealth tax, much like cities impose annual property taxes. In designing such a wealth tax, the two rationales for taxing wealth as such do not lead to great structural differences other than those related to the size of the exemption amount. If one's goal is to better reflect one's ability to pay, the tax's scope would presumably have a reach similar to today's income tax. In contrast, if the concern is the impact of large fortunes on the political or economic system, a much larger exemption suggests itself. A trust fund of $1 million, for example, affects its holder's ability to pay but probably does not impact the political or economic system. To that end, a wealth tax designed to fight the political and economic externalities associated with large fortunes would likely have an extremely high exemption amount – at least several million dollars and perhaps as high as ten or twenty million dollars – while one reflecting ability to pay principles would have a much lower exemption.

Which types of assets would count towards one's net worth? Thomas Piketty, whose proposed global tax on capital recently popularized the idea of wealth taxes, spends little time discussing his ideal base other than saying that his tax would apply to "all types of assets … real estate, financial assets, and business assets – no exceptions."[41] David Shakow and Reed Shuldiner's proposed comprehensive wealth tax is similar but more detailed.[42] Their wealth tax base would include the value of one's financial holdings; farms and other businesses; nonfinancial investment assets such as real estate and art; consumer durables over an exemption level of somewhere between $10,000 and $50,000; and the net value of housing above $1,000,000. For administrative reasons, the base would exclude the value of term life insurance (if any) but include the value of whole life policies; it would also exclude the value of contingent liabilities (such as a pending claim against an alleged tortfeasor). For political reasons related to their

[40] *See, e.g.*, Noel B. Cunningham, *The Taxation of Capital Income and the Choice of Tax Base*, 52 TAX L. REV. 17, 44 (1996); Deborah H. Schenk, *Saving the Income Tax with a Wealth Tax*, 53 TAX L. REV. 423, 435-41 (2000).

[41] PIKETTY, *supra* note 1, at 517.

[42] Shakow & Shuldiner, *supra* note 22, at 532-46. Although Shakow and Shuldiner propose that their wealth tax – in conjunction with a flat tax on wages – replace the existing income tax, *id.* at 499-500, their proposal nonetheless illustrates what a wealth tax designed to accompany, not replace, the income tax might look like.

current favorable income tax treatment, Shakow and Shuldiner's plan would also exclude the value of qualified retirement assets. Lastly, their plan would account for outstanding debt, so that net, not gross, values are taxed.

Such a tax could be levied either annually or less frequently, though Piketty and Shakow and Shuldiner all favor the former. Although Shakow and Shuldiner suggest a flat rate of 1.57%,[43] Piketty proposes a progressive tax, although he is somewhat unclear about exactly how progressive it should be. He envisions taxing fortunes between 1 and 5 million Euros at 1% and those over 5 million at 2%, and perhaps taxing those with very large fortunes of over 500 million or 1 billion Euros at rates as high as 5 or 10%, depending on the rate of return. Moderate wealth (under 1 million Euros) would be exempted, or taxed at much lower rates of .1% for wealth of up to 200,000 Euros and .5% for wealth of between 200,000 and 1 million Euros.[44]

These choices – of exemption levels, the appropriate base, the rate, and any relief provisions for taxpayers with illiquid assets – are the most important structural decisions a policymaker would face when implementing an ideal wealth tax. Of course, he or she would also face a number of more technical decisions, such as the treatment of discretionary interests in trust and powers of appointment. Those details, however, are beyond this Essay's scope.

B. The Problems with a Federal Wealth Tax

The foregoing appears simple: Policymakers will define the base, choose rates, and decide upon an exemption level. In reality, however, practical and administrative considerations suggest that implementing a wealth tax is more difficult than it appears.

1. Valuation Issues

The main problem with an annual wealth tax is the necessity of annual valuations. (This problem also plagues an income tax with no realization requirement, as Part III.C. discusses). Annual valuations are costly, complicated, and encourage taxpayers to employ a variety of avoidance strategies to artificially deflate value, thereby undercutting the effectiveness of an annual wealth tax.[45] As Deborah Schenk and Noel Cunningham have remarked in a similar context, "[a]ny system requiring appraisals is likely to be a loss for the government because it does not have the resources to win."[46]

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[43] *Id.* at 529.
[44] PIKETTY, *supra* note 1, at 517, 529.
[45] James R. Repetti, *It's All About Valuation*, 53 TAX L. REV. 607, 608 (2000).
[46] Noel B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A "Revolutionary" Approach to Ownership*, 47 TAX L. REV. 725, 743 n.78 (1992).

Those of us whose income comes largely from academic salaries may wonder what's so hard about valuation. Momentarily setting aside real estate, valuing the assets of salaried professionals – which generally consist of cash, life insurance, and retirement and other brokerage accounts largely containing bonds and publicly-traded stocks – is fairly straightforward. If the portfolios of wealthy taxpayers differed from ours solely in size and value, then valuation difficulties would be less problematic (although incentives to hide assets or artificially deflate value would still exist).

The holdings of the wealthy, however, also differ in kind. Many "somewhat" wealthy individuals that would be targeted by an ability-to-pay wealth tax (perhaps those with net worths of $500,000 or $1,000,000) are small business owners or own real estate. As discussed below, valuing such assets is a difficult and imprecise task. Moving from somewhat wealthy individuals to very wealthy individuals, their portfolios become even more difficult to value. According to recent estimates by David Kamin, roughly half of the assets owned by the wealthiest 1% of Americans are not easily valued, as shown below:

Shares of Gross Wealth for Taxpayers with Wealth over $2 Million (2007)[47]	
Neither publicly traded nor easily valued:	**49%**
Real estate	22%
Closely-held stock	12%
Noncorporate Business Assets	7%
Farm assets	3%
Private Equity and Hedge Funds	3%
Other (Other limited partnerships, art, etc)	2%
Publicly traded or easily valued:	**51%**
Publicly-traded stock	19%
Bonds	9%
Retirement Assets	9%
Cash	8%
Mortgages and Notes	2%
Other (mutual funds, insurance, other assets)	4%

As any seasoned estate tax practitioner will attest, most estate tax litigation is not about whether a given asset is included in a decedent's estate. Instead,

[47] Kamin, *supra* note 18, at 123.

disagreements more frequently concern the value of an asset that everyone agrees is includible. This complexity stems from a variety of causes.

a. Methods

The first area of dispute is what valuation method to use. Current law determines value objectively, using a willing buyer-willing seller standard that seeks to identify "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."[48] Identifying that price is easy when identical or similar assets are routinely bought and sold on public markets; to value publicly-traded stock, for example, all one need do is identify the trading prices on the valuation date.[49] The portfolios of the wealthy, however, often contain assets that are either unique (art, some real estate) or not publicly traded (closely-held stock). In these cases, a variety of techniques – each potentially yielding different results – could be used.

Closely-held businesses. To illustrate, consider various methods for valuing a closely-held business. The simplest approach is to look at the company's balance sheet, add up the value of all the assets, and subtract outstanding liabilities. In most cases, however, this method undervalues the company because balance sheets frequently exclude intangibles such as goodwill, going concern value, customer lists, trademarks, and the like. Moreover, an asset's value as shown on a balance sheet rarely corresponds with its actual fair market value. For these reasons, this method is mainly used to value investment and real estate holding companies.[50]

Two other valuation approaches predominate for active businesses that sell goods or services; the first is to look at the sale of comparable publicly-traded companies in the same or similar industries. Identifying a comparable publicly-traded company, however, involves weighing a host of factors: size, market share, geographic location, diversification of assets, and financial security. Even when two companies are in the same industry, differences in these factors can cause significant disparities in value. One might also identify publicly-traded companies in the same industry that have earnings similar to the closely-held business being valued, determine the price/earnings ratio of the former, and apply that ratio to determine an estimated value for the latter.[51]

The second approach often used for active businesses is to estimate the income stream of the business being valued, and then to estimate the present value of that income stream. Estimating both the expected income stream and its future value require a number of judgments. Consider the expected income stream.

[48] Reg. §§ 20.2031-1(b); 25.2512-1.
[49] Reg. § 20.2031-2(b)(1).
[50] RAY MADOFF, PRACTICAL GUIDE TO ESTATE PLANNING 11,012 (2012).
[51] *Id.* at 11,013-14.

Which of net profits, cash flow, or gross revenue (each of which will have different results) should be used? Is the company's past performance a reliable indicator of future performance, or are future changes in the company's circumstances indicated? Likewise, determining that income stream's present value requires determining the appropriate discount rate, which depends on the current risk-free rate of return, general economic volatility, the economic characteristics of the business's industry, and some attributes of the specific company being valued. Although appraisers frequently use studies that use survey data to estimate discount rates for various industries, they must still determine to what extent the business being valued is similar to the industry as a whole.[52]

Real estate. Similar difficulties arise when valuing real estate. For example, most local property tax systems use comparable sales to determine a home's value, which raises its own set of questions. What time period should be used to determine relevant sales? What homes are comparable? Some comparisons are objective, such as square footage and lot size, but many are not. How should neighborhood quality and curb appeal be measured? How should the value of improvements such as kitchen and bath remodels be accounted for?[53]

While real estate appraisers have developed sophisticated databases and formulas to wrestle with these and other factors, taxpayers and the government alike have access to these. Both sides to assessment disputes therefore present huge amounts of information, much of it subjective. Often, adjudicators reject both sides' estimates and pick their own.[54] Taxpayers have no incentive to reveal what they believe to be the value of their properties, or to challenge valuations that they believe to be low. For these reasons, most commentators believe that real property assessments are inaccurate, even after appeals and disputes.[55]

b. Valuation Discounts (and Premiums)

The second area of dispute is the applicability of discounts and premiums when valuing jointly-owned assets such as closely-held businesses. Imagine that *Frank* owns all 1,000 shares of *X. Corp*., whose total value is $100,000 or $100 per share. This value presumably reflects the fact that *Frank*, as sole shareholder, has sole control of *X Corp*. and its assets. He selects the board of directors, who in turn decide who to hire (often *Frank* himself), whether to pay dividends, and so on. As sole shareholder, *Frank* will also be able to decide whether to liquidate,

[52] *Id.* at 11,014.
[53] Stewart E. Sterk & Mitchell L. Engler, *Property Tax Reassessment: Who Needs It?*, 81 NOTRE DAME L. REV. 1037, 1068-69 (2006).
[54] Edward A. Zelinsky, *For Realization: Income Taxation, Sectoral Accretionism, and the Virtue of Attainable Virtues*, 19 CARDOZO L. REV. 861, 882 (1997).
[55] Sterk & Engler, *supra* note 53 at70; Zelinsky, *supra* note 54, at 882; William Doerner & Keith Ihlanfeldt, *An Empirical Analysis of the Property Tax Appeals Process*, 10 J. OF PROP. TAX ASSESSMENT & ADMIN. 5 (Federal Housing Finance Agency, Florida State University 2014).

sell corporate assets, merge with other corporations, or amend corporate documents.[56]

Assume that *Frank* sells 200 shares to each of *Georgia* and *Henry*, keeping 600 shares for himself. Because neither *Georgia* nor *Henry* controls a majority of *X Corp*.'s stock, each of their shares is less valuable than each of *Frank*'s shares. Their lack of control is reflected in a "minority interest discount." Courts often apply discounts of twenty to thirty percent when valuing minority interests, meaning, for example, that *Georgia*'s shares might be valued at $70 or $80 instead of $100 a share. Had *Frank* sold more than 50% of his holdings (perhaps 26% to each of *Georgia* and *Henry*), his retained shares would likewise be eligible for a minority discount.

Alternatively, *Frank* could have created a partnership in which he holds a 1% general partnership interest and *Georgia* and *Henry* each own a 48.5% limited partnership interest. As limited partners, *Georgia* and *Henry*'s partnership interests would be eligible for a lack of control discount because *Frank*, as general partner, would still control the partnership. This would be true even if *Georgia* alone owned a 99% limited partnership interest, which lacks control even though it is a majority interest. And although *Frank*'s interest will trigger a control premium, the value of what he owns is far less than when he alone owned the entire business because he only owns 1% of its assets.

A third discount (which applies to both corporations and partnerships) is a lack of marketability discount. Often, closely-held businesses restrict owners' abilities to transfer their shares or liquidate. Even if the organization's governing documents do not contain such a restriction, an outsider is less likely to buy into a closely-held corporation than into one with broad public ownership. This discount frequently reduces the value of ownership interest by an average of an additional 15%.[57]

In many instances, both the division of ownership and marketability restrictions result in a real diminution of value. This is especially true when the business in question is an ongoing enterprise requiring active management decisions, since unrelated parties face high transaction costs in dealing with one another to make these decisions. Families, however, frequently leverage the foregoing discounts in two ways.

First, because the buyer and seller in the willing buyer-willing seller valuation standard are hypothetical individuals, the foregoing discounts are calculated as if the relevant parties were unrelated individuals. Imagine that *Father* owns 40% of *X Corp.*, with *Son* and *Daughter* each owning 30%. Perhaps

[56] James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 426-27.
[57] *See, e.g.*, Paul L. Caron & James R. Repetti, *Revitalizing the Estate Tax: 5 Easy Pieces*, TAX NOTES 1231, 1232 n.8 (March 17, 2014).

Son and *Daughter* get along famously and decide to make decisions together so that they, not stodgy *Father*, effectively control *X Corp*. Even so, *Son* and *Daughter*'s shares are valued in isolation, ignoring the fact of their unity. Of course, family members do not always have identical interests, and in many cases will behave the same as unrelated individuals. Nevertheless, it is quite likely that family members will act in concert more often than non-family members and that minority and lack of control discounts are frequently overstated when all interests are owned by related parties.[58]

Second, these valuations apply even when the business enterprise in question does nothing more than hold real estate or other investment assets. Imagine that *Father* owns $1,000,000 worth of publicly traded stocks in a variety of companies. When *Father* alone owns those shares outright, the stocks are easily valued. If *Father* makes an outright transfer of one-third of the stocks to *Son* and one-third to *Daughter,* keeping one-third for himself, the value of each person's resulting holdings is also easily identifiable.

Imagine instead, however, that *Father* creates a limited liability company (known as a family limited liability corporation or "FLLC") to hold the stocks, and transfers one-third of the shares in the FLLC to *Son* and one-third of the shares to *Daughter*. Or perhaps *Father* creates a partnership (known as a family limited partnership or "FLP") in which he retains a general partnership interest and gives *Son* and *Daughter* limited partnership interests. Further assume that the organization's governing documents contain liquidity restrictions.

Now the holdings of *Father, Son* and *Daughter* are eligible for the discounts just discussed, and each interest will be valued at less than $333,333. This is true even if the family enterprise does nothing more than hold publicly-traded stocks. Assume for example, that one of the stocks in the FLLC's portfolio distributes dividends. As a legal matter, no single shareholder of the FLLC can require it in turn to distribute those dividends to the FLLC's shareholders. Technically, therefore, the interests of *Father, Son* and *Daughter* each warrant a minority interest discount.

Simply placing assets in an FLLC or FLP therefore allows the wealthy to diminish the value of their property. As shown, this diminution is often artificial when the enterprise is controlled by family members and does nothing more than hold investment assets. Given the prevalence of such techniques to reduce estate and gift taxes, one would assume an annual wealth tax would further increase their use.

c. Anti-abuse Mechanisms?

To be sure, Congress could pass legislation curbing some of these techniques, for example, by requiring attribution of ownership among family

[58] *Id.* at 1233-34.

members when determining whether to apply a minority or lack of control discount.[59] Attribution rules, however, are not a cure-all. In many cases, especially where the enterprise is nothing more than a holding company for real estate and other investment assets, taxpayers will simply team up with individuals not covered under the attribution rules. *Iris*, for example, might form an LLC with her friends *Jordan* and *Katherine*, to which each contributes an equal amount of stock. Each shareholder's portion of the LLC will be valued at less than the fee simple value of the stock.

Moreover, attribution rules do not address other limitations that can diminish the value of LLC or partnership interests, such as liquidation restrictions that trigger lack of marketability discounts. As responses to the estate and gift taxes show, taxpayers exhibit unlimited creativity in crafting transfers and ownership structures that artificially diminish value. If Congress curbed the use of minority discounts, taxpayers would quickly create new LLC and partnership restrictions to trigger other discounts, still rendering valuation of these interests administratively burdensome.

d. The Importance of Valuation

At first glance, one might wonder whether the valuation difficulties just described would play as large a role under a wealth tax as they do in the current estate and gift tax system. After all, its top rate is 40%, compared to the much lower rates in most wealth tax proposals. Recall that Shakow and Shuldiner suggest a flat 1.57% rate. Piketty is less specific about his top rate, first mentioning a top rate of 2% but later suggesting a rate of 5% to 10%, depending on the rate of return, for the very largest fortunes. One might therefore assume that a wealth tax creates fewer incentives to challenge valuations or deflate asset values than the current estate and gift tax systems.

Comparing the low nominal rate of an annual wealth tax, however, to the higher nominal rate of a one-time transfer tax is misleading. Assume that *Laura* holds an asset for a thirty-year period during which time the discount rate is a constant 6%. Jim Repetti has shown that an annual 1.57% tax (as proposed by Shakow and Shuldiner) during that thirty-year is equivalent to a one-time tax of 23% in *Year 1* if the asset does not appreciate in value and a one-time tax of 47.10% in *Year 1* if the asset appreciates at 6%.[60]

Saul Levmore similarly demonstrates that the higher rates proposed by Piketty often exceed the rate of return net of income taxes, which means that one's assets won't generate enough income to pay the wealth tax and must therefore be liquidated to do so. Consider a 33% income tax coupled with a 6% wealth tax and assume that *Laura* earns $1,000,000, which she invests at 6%. As Saul Levmore has shown, the income tax reduces *Laura's* after-tax rate of return

[59] *Id*. at 1235.
[60] Repetti, *supra* note 45, at 610.

to 4%; which is less than the amount of income needed to pay the 6% wealth tax. "Slowly but surely," Levmore notes, "the two tiers of taxation would confiscate the original income."[61]

This example demonstrates how high the stakes are in terms of valuation disputes. If *Laura* can convince the government that her asset is worth less than $1,000,000, she lessens the bite of the wealth tax. Re-conceptualizing the tax rate in this manner more clearly shows that the incentives to challenge valuations and artificially deflate asset values are just as strong in a wealth tax as in the current estate tax. The number of property tax valuation challenges that occur whenever localities reassess values further illustrates how important the stakes are to taxpayers: frequently, one-quarter to one-third of homeowners challenge the new valuations, and appeals have increased in many municipalities over the past decade, given the swings in the housing market.[62]

Further, an annual wealth tax would almost certainly generate a much higher number of valuation disputes than the current estate tax system. This is so for a variety of reasons. First, because everyone with wealth above a given exemption level – and not just decedents or individuals who make inter vivos gifts – would be subject to the tax, the pool of individuals responsible for valuing their assets in a given year would be larger. To illustrate, under current law, with its $5,450,000 per-decedent exemption, only an estimated .2% of decedents' estates in a given year must file estate tax returns and deal with valuing assets.[63] In the mid-1990s, when the per-decedent exemption much lower – $600,000 – at most about 2% of estates (roughly 30,000 estates) were subject to the estate tax.[64]

Even then, noted Tax Court Judge Theodore Tannenwald quipped that we "already have more valuation cases than we know what to do with."[65] The number of decedents with a given wealth level is much smaller than the number of living individuals with that same wealth level who would need file wealth tax returns – even if the tax was limited to the wealthiest 1 or 2% percent of the population. Reaching deeper into the population, of course, would further increase the number of annual returns.

Moreover, the annual nature of a wealth tax – as opposed to the one-shot nature of the gift and estate tax system – will also lead to an increased number of disputes. If a taxpayer loses on a valuation issue in an estate tax dispute, once the appeals process is over, that's generally it. The valuation stands. But if they lose a valuation dispute in *Year 1* of a wealth tax, they may well try to challenge the valuation again in *Year 2*. Although courts are generally hesitant to adopt new

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[61] Saul Levmore, *Inequality in the Twenty-First Century*, 113 MICH. L. REV. 833, 851 (2015).
[62] Sterk & Engler, *supra* note 53, at 1067, 1071; Doerner & Ihlanfeldt, *supra* note 55, at 5.
[63] Joint Committee Report, *supra* note 15, at 30.
[64] *Id.* at 25.
[65] Sheryl Stratton, *Estate Tax Valuation Proposal Makes Judge Tannenwald Cringe*, 69 TAX NOTES 1442, 1442 (Dec. 18, 1995); quoted in Repetti, *supra* note 45, at 612.

valuation methods once one has been established for a given asset,[66] it is not inconceivable that taxpayers may attempt a challenge nonetheless. Consider the valuation of a small business. To name just a few, if any of general economic conditions, conditions in that specific market, or technology change, a taxpayer may feel he or she has grounds for a challenge. The government faces similar incentives if it loses in *Year 1*.

Finally, valuation challenges frequently take years to resolve. Although this may delay the closing of an estate, it will only occasionally bleed over into a later dispute about a separate estate. But with a wealth tax, the outcome of a valuation challenge in *Year 1* will almost certainly affect that asset's valuation in *Year 2*. A lengthy challenge over *Year 1*'s valuation thus creates a ripple effect impacting the taxation of the asset in later years.

For these reasons, policymakers should take administrability concerns related to valuation seriously.

2. Constitutional Issues

In addition to implementation difficulties, a wealth tax faces an additional hurdle: it is likely unconstitutional. The Constitution prohibits direct taxes unless they are "apportioned among the states," which means that each state's overall tax burden is proportionate to its population.[67] Consider Maryland and Missouri, each of which (rounding a bit) is estimated to contain roughly 1.9% of the total population.[68] The Apportionment Clause requires that Maryland and Missouri residents each bear 1.9% of any direct tax's total burden – regardless of the extent to which the tax base in each state differs. To illustrate, assume that an income tax was a "direct tax" subject to the apportionment clause. (To be clear, the Sixteenth Amendment excepts an income tax from the apportionment clause). If it was subject to the clause, however, then Missouri residents (median income $57,917) would have to be taxed at a much higher rate than Maryland residents (median income $86,056) for the two states' income tax burdens to be equal.[69]

Designing a tax in this manner is clearly absurd, ruling out the use of federal direct taxes.[70] Are wealth taxes "direct taxes" subject to the apportionment clause? Most likely. The phrase "direct taxes" is generally thought to mean "property taxes," and that is precisely what a wealth tax is.[71] It taxes property,

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[66] Repetti, *supra* note 45, at 610.
[67] U.S. Const., art. I, § 9, cl. 4; Bankman & Shaviro, *supra* note 2, at 489.
[68] United States Census Bureau, *American Fact Finder*, available at http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=PEP_2015_PEPANNRES&src=pt (author's calculation, using 2015 estimates).
[69] United States Census Bureau, *Median Family Income in the Past 12 Months (in 2011 Inflation-Adjusted Dollars) by Family Size*, https://www.census.gov/hhes/www/income/data/statemedian/.
[70] *See* Bankman & Shaviro, *supra* note 2, at 489; Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1,1 (1999).
[71] Bankman & Shaviro, *supra* note 2, at 489.

albeit a broader class of property than the local real estate taxes to which we are accustomed. As such, a wealth tax would likely need to be apportioned among the states in order to be constitutional.[72]

To be sure, some commentators argue otherwise. Bruce Ackerman, for example, contends that jurisprudence over the past 100 years suggests that courts do (and should) interpret the phrase "direct taxes" too narrowly to cover a wealth tax. In his view, *Pollock v. Farmers' Loan & Trust Co.*, which held (prior to the 16th Amendment) that an income tax was a direct tax requiring apportionment, is an aberration that has been repudiated by later precedent. His argument rests in part on the clause's origins; it was a compromise over slavery during the constitutional convention. As he explains, "the South would get three-fifths of its slaves counted for purposes of representation in the House and the Electoral College, if it was willing to pay an extra three-fifths of taxes that could be reasonably linked to overall population."[73] For similar reasons, Calvin Johnson argues that the clause applies only to head taxes, and that courts should reject apportionment in other cases where its application creates absurd results.[74] Lastly, Joseph Dodge takes the middle ground, contending that the clause would apply to taxes on real and tangible personal property, but not intangible property like stock.[75]

As recently as 2012, however, the Supreme Court indicated that the apportionment clause was still relevant. In upholding the Affordable Care Act's tax penalty, it noted that the penalty "does not fall within any recognized category of direct tax" and was "plainly not a [direct] tax on the ownership of land or personal property."[76] The Court's discussion, moreover, points to its 1895 decision in *Pollock* as a break with its prior jurisprudence, which had interpreted the clause narrowly.[77] In contrast to Ackerman's analysis, this language implies that the Court will continue to interpret the clause broadly and would likely consider a wealth tax to be a direct tax.[78] In any case, the possibility that a wealth tax is unconstitutional would likely play a large role in the political discourse surrounding its enactment, suggesting that policymakers might be wise to search for alternatives lacking the taint of possible unconstitutionality.[79]

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[72] *See* Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Unconstitutional?*, 97 COLUM. L. REV. 2334, 2350-97 (1997) (discussing the apportionment clause in the context of consumption taxes).
[73] Ackerman, supra note 70, at 4-6.
[74] Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution*, 7 WM. & MARY BILL RTS. J., 1, 4-5, 72 (1996).
[75] Joseph M. Dodge, *What Federal Taxes are Subject to the Rule of Apportionment Under the Constitution?,* 11 U. PA. J. CONST. L. 839, 843, 933-34 (2009).
[76] *National Federation of Independent Business v. Sebelius*, 132 S. Ct. 2566, 2599 (2012).
[77] *Id*. at 2598.
[78] Bankman & Shaviro, *supra* note 2, at 489-90 n. 140.
[79] *Id*. at 491-92.

C. Second-Best Options

Given the practical drawbacks of an annual wealth tax, those seeking to tax wealth itself will likely need to consider second-best options. Here, the policymaker faces two options: Altering the income tax system's treatment of wealth and capital, or adopting some type of transfer tax. Neither is a perfect proxy for a wealth tax. Consider an estate tax. By focusing on the transfer of wealth at death, it implies that first-generation wealth is not harmful. It leaves that generation's wealth untouched, although its imposition theoretically slows the build-up of wealth by younger generations by reducing after-tax amounts transferred to them. (If the first generation's motive for amassing wealth is to pass it on, however, it might plausibly respond to a wealth transfer tax by accumulating a larger fortune than in a no-tax world).

In contrast, strengthening the income tax reflects a normative judgment that the initial build-up of wealth in the first generation should be slowed. Wealth comes from somewhere. Its appearance and growth constitute income as a theoretical matter, regardless of its source. This is easy to see when the source of wealth is one's salary, since we are used to conceiving of salary as income. It is also true, however, when one's wealth comes from the increase in value of one's stock portfolio. As discussed in Section II.A., this increase is technically income (even if not currently taxed) because it renders one better off. And by minimizing what the first generation accrues, a stronger income tax would also mean less was available to pass down to later generations (subject to the same caveat mentioned above about one's motives for amassing wealth).

Thus, if one's concerns are wealth concentrations as such or ability-to-pay-principles, of the second-best options, a stronger income tax is a more theoretically pure tool than a wealth transfer tax. This Section briefly discusses various options for strengthening the income tax system and their major practical ramifications, concluding that the best second-best option is to treat death as a realization event in conjunction with removing the preferential rate treatment for capital gains.

1. Ordinary Income and the Rate Structure

Those not steeped in tax generally fixate on ordinary income rates as indicators of how heavily the wealthy are taxed. Under current law, the highest marginal rate that applies to labor and other ordinary income is 39.6%. For comparison, top marginal rates from 1965 to 1980 were 70%; in the 1950s and early 1960s, top rates exceeded 90%.[80] This contrast – coupled with America's almost unprecedented and widely shared economic growth during the middle-part of the 1900's – has led many to call for an increase in ordinary tax rates as a means of fighting inequality.

[80] Tax Foundation, *Historical Highest Marginal Income Tax Rates* (2015), available at: http://www.taxpolicycenter.org/taxfacts/Content/PDF/toprate_historical.pdf .

These numbers, however, mask the fact that in reality the top rates affected very few Americans. Many taxpayers who would otherwise have been in the top brackets took advantage of an unprecedented number of deductions, exemptions and exclusions, many made possible by the proliferation of the tax shelter-industry. Thus, the nominally high tax rates of the past hide much lower effective tax rates. In fact, income tax revenue as a share of gross domestic product has been relatively flat since the 1950s, despite wide variations in the rate structure.[81] Moreover, boosting rates on ordinary income will do nothing but increase taxpayer efforts to convert ordinary income into capital gains unless the treatment of capital income is changed as well.[82] Lastly, much of the wealthy's income is capital in nature, to which current law applies preferential rates. Even in the unlikely scenario that increased rates on labor income did not trigger conversion techniques, those rates would not apply to a substantial portion of the wealthy's income.

2. Changing the Treatment of Capital Income

Given the large proportion of capital income in the wealthy's portfolio, the most effective way of strengthening the income tax is to change the tax treatment of capital income. Of possible such reforms, making death a realization event is superior to other possibilities.

a. Increasing the capital gains rate

One option, for example, would be to raise the rate applicable to capital gains. Although so doing would limit the use of techniques that convert ordinary into capital income, standing alone, it would still be largely ineffective in increasing taxes on the wealthy due to the realization rule. This is so because decisions about when to realize capital income – such as how long to hold capital assets – are among the most sensitive to changes in tax rates.[83]

b. Abandoning the realization rule in whole or in part

In that case, why not also abandon the realization rule? In such a system – sometimes called an accretion-based or a mark-to-market income tax – increases in the value of one's assets are treated as income, even if not sold by the taxpayer. The necessity of annual valuations, however, means that the same valuation, administrative, and liquidity problems that plague an annual wealth tax would also afflict an accretion-based income tax. Practical considerations therefore render this approach unworkable.

[81] Tax Policy Center, *Historical Source of Revenue as Share of GDP*, available at http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=205.

[82] *See* Kamin, *supra* note 18, at 127-28.

[83] *Id*. at 120-21.

That said, one possible method of taxing the wealthy more heavily would be to adopt mark-to-market taxation for easily-valued assets such as publicly-traded stock, which would solve some of the administrative problems that vex a broad accretion-based tax.[84] As with a wealth tax, taxable assets below a given level (depending on whether the tax targeted the merely wealthy and above, or only the ultra-wealthy) could be exempted. While this approach has some promise, its ability to reach the very wealthy (as opposed to those with a few hundred thousand or one or two million dollars) is limited. Namely, less than half the portfolios of taxpayers with wealth over $2 million dollars would be taxed under this approach. David Kamin estimates that for such taxpayers, publicly-traded stock comprises an average of 19% of their portfolios, with bonds and retirement assets each making up another 9% and retirement assets constituting less than 4%.[85] Moreover, such an approach would likely cause taxpayers to reallocate their portfolios to increase the percentage held in exempt assets.[86]

c. Changing the tax treatment of capital gains at death

The most promising option to address the preferential treatment of capital income (in conjunction with discarding its preferential rate treatment) is to fix the gap that allows unrealized appreciation at death to escape taxation forever. Recall *Alice*, who purchases stock at $100, dies when it is worth $450, and bequeaths it to *Ben*. When *Ben* later sells the stock, he will owe tax only on any increase in value above $450. The $350 increase in value in *Alice*'s hands is never taxed, due to the stepped-up basis rule.

Two reforms could potentially erase this gap, both of which could be pursued even if lawmakers retained preferential rates. First, the carry-over basis rule currently applied to gifted property could be applied to property received by bequest. If so, *Ben* would take *Alice*'s $100 basis and be taxed at sale on any increase in value over $100. Such a solution presents its own challenges, namely involving the difficulties of keeping basis records when decades might pass between the decedent's purchase of the assets and the sale of such assets by heirs.[87] This is less of a problem when carry-over basis is applied to gifts, since the donor is alive at the time of the gift. Further, this rule could create lock-in incentives on the part of donees to hold onto assets received by bequest for long periods of time to avoid tax, even if the property's highest and best use is in someone else's hands. Notably, Congress passed legislation implementing carry-over basis at death in 1976 but repealed it in 1980 before it had taken effect.[88]

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[84] Our current system already applies mark-to-market taxation to a select group of assets, such as securities held by traders and certain types of bonds.
[85] Kamin, *supra* note 18, at 123.
[86] *Id.*
[87] *See* Laura E. Cunningham and Noel B. Cunningham, *Realization of Gains Under the Comprehensive Inheritance Tax*, 63 TAX L. REV. 271, 276-78 (2009).
[88] Senate Budget Committee, *Tax Expenditures, Compendium of Background Material on Individual Provisions* 417 (Dec. 28, 2012). The scheduled one-year repeal of the estate tax in 2010 also included carry-over basis provisions; retroactive legislation maintaining the tax gave the

Alternatively, death (and possibly gift) could be treated as a realization event, whereby *Alice* would be taxed on the stock's increase in value in her hands whenever she transfers it to *Ben*. This approach has several advantages over implementing carry-over basis at death. First, as a symbolic matter, it taxes the original holder of the appreciated assets, instead of his or her heirs. This reflects – at least on a theoretical level – that the concern is with the existence or accumulation of wealth and not just its transfer. Moreover, making death a realization event sets the taxable event sooner (at the decedent's death) rather than later (if and when the recipient sells, as would be the case with carry-over basis). This imposes earlier limits on the amount of wealth that can be accumulated by the next generation, even if it does not limit such accumulation in the hands of the initial holder as a practical matter. Lastly, it minimizes the lock-in incentives associated with the current system or those that would accompany carry-over basis at death.[89]

Although valuation and liquidity problems would still exist, their magnitude would be much less than under either an accretion-based income tax system or an annual wealth tax because the tax event would occur roughly once per generation, instead of annually. Moreover, heirs already face the necessity of valuing assets at death in order to determine their basis for later sale. In that sense, the administrability concerns from making death a realization event are roughly equivalent to those in the current income, estate and gift tax systems, with one exception: the decedent's basis would have to be determined in order to calculate her gain or loss. This is also true, however, in the case of implementing carry-over basis for bequests, and would be somewhat less difficult if death was a realization event since less time will have elapsed between the decedent's acquisition of an asset and its taxation. Moreover, executors would not have to worry about equitably distributing basis among heirs, as they would with carry-over basis.[90]

As with the current estate and gift tax system, a threshold amount of gains per decedent could be excluded from tax (depending on the tax's target), easing some of the concerns just identified. Moreover, this option could be pursued regardless of whether capital gains continue to enjoy preferential rate treatment. Of course, treating death as a realization event would require working out a number of additional technical details, many of which have been thoughtfully addressed elsewhere.[91]

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estates of 2010 decedents a choice between paying the estate tax or using carry-over basis. Joint Committee Report, *supra* note 15, at 10-11.

[89] Cunningham & Cunningham, *supra* note 87, at 278-79.

[90] *See* Lawrence Zelenak, *Taxing Gains at Death*, 46 VAND. L. REV. 361, 368 (1993).

[91] *See generally id.*

3. Death As a Realization Event Compared to an Estate Tax

How, one might wonder, is making death a realization event any different from imposing an estate tax? Both treat death as a taxable event, after all. As an initial matter, the two have very different normative and political implications. Locating the taxable event in the income tax system, rather than the transfer tax system, better reflects that the greater concern is the accumulation of wealth as such, rather than its transfer. Making death a realization event also has political advantages. Namely, it fixes a gap in the income tax system, instead of layering an entire second tax system upon the income tax system. It is thus completely immune from charges that it is double taxation. Moreover, intellectually honest academics and policymakers who oppose wealth or wealth transfer taxes admit that the current treatment of gains at death creates a loophole that benefits the wealthy.[92] Although anything that is viewed as increasing taxes faces a high political bar, making death a realization event at least has theoretical roots that serious, apolitical thinkers across the political spectrum agree is fair.

The two also have slightly different technical implications. The most serious is that an estate or accessions tax only requires knowing an asset's fair market value at death, whereas making death a realization event also requires knowing the asset's basis. Because the decedent is dead, this obviously requires reliance on his or her records. It is true that some individuals may currently fail to keep adequate basis records during their lifetimes in anticipation of the fair-market value step up at death. That said, were death to become a realization event, it is likely that most taxpayers would begin keeping basis records going forward. In cases where no such records are available, alternative methods of establishing basis could be used, including various methods for estimating basis. Moreover, basis problems have not undermined Canada's system of taxing gains at death.[93]

A last matter is the question of rates and exemption levels. Based on current law, one might assume that an estate tax would necessarily have higher rates of tax than a system of taxing gains at death. Current estate and gift tax rates are 40%, for example, compared to top capital gains rates of 23.8%. Current practice need not govern a new system, however. If the goal is taxing wealth more heavily, there is no reason that treating death as a realization event could not be coupled with repealing the preferential rates for capital gains. Under current law, this would mean that a top rate of 39.6% would apply to gains realized at death. Moreover, a certain amount of gains per decedent could be exempted from taxation at death; this exemption could be set at whatever level best matched the rationale for taxing gains at death. If the rationale was ability to pay, the exemption level would likely be rather low – a few hundred thousand dollars, perhaps. If the rationale was that large wealth concentrations harm the political

[92] *See, e.g.*, Richard A. Epstein, *Death by Wealth Tax*, available at http://www.hoover.org/research/death-wealth-tax.
[93] Zelenak, *supra* note 90, at 389-95.

or economic system, the exemption would likely be much larger, at least several million dollars.

IV. TAXING WEALTH TRANSFERS

As described in Section II, a third common justification for taxing wealth -- minimizing dynastic wealth – actually encompasses two distinct notions. The first, rooted in equality of opportunity ideals, is that it is unfair for one's life prospects to turn on the chance circumstances of one's birth. The second concern is that the ability of some families to pass economic and political power down to younger generations contradicts the democratic ideal that such power should be earned, not inherited. Although I have extensively discussed the latter elsewhere,[94] this Section shall focus on the equality of opportunity ideal, as it is the more common interpretation. This concern suggests a tax on the transfer of wealth, which could be done in three ways: an estate tax that taxes transferors, an accessions tax that taxes recipients, or requiring recipients to include gifts and bequests income. As discussed below, taxing recipients of gratuitous transfers via a cumulative progressive accessions tax best reflects equality of opportunity concerns.

A. An Ideal Accessions Tax Inspired by Equality of Opportunity

The equality of opportunity ideal, broadly speaking, holds that the chance circumstances of one's birth should not govern life outcomes. Under this view, the ability of some families to pass along financial advantages to their children upsets equality of opportunity ideals because children have varying opportunities to develop fully their talents based on the economic circumstances of their birth.[95] Some children are born into families that can afford tutors, expensive music lessons, and sports camps; others are not. Some children must work multiple jobs during the summer to help pay the rent, while others participate in prestigious internships or take educational trips to Europe. Proponents of this ideal argue that wealth (or wealth transfer) taxation is appropriate to level the playing field so that one's education, occupation, and social class are not determined by the chance circumstance of being born into a rich or poor family.

1. The Basics of an Equality of Opportunity Focused Accessions Tax

A transferee-focused accessions tax better demonstrates these concerns as a theoretical matter than either of an annual wealth tax, inclusion of gifts and bequests in income, or our current, transferor-oriented estate tax.[96] Consider our transferor-oriented estate tax. Recall that under current law, wealthy individuals are taxed on the total amount of wealth that they gratuitously transfer over the

[94] *See* Fleischer, *supra* note 34.
[95] *See, eg.*, Alstott, *supra* note 2, at 516.
[96] This discussion of equality of opportunity and an accessions tax borrows heavily from Alstott, *supra* note 2.

course of their lifetimes. The recipient's identity is largely irrelevant, unless the recipient is a spouse or charity. If *Moira* dies with $5,000,000 she is taxed the same whether she leaves all $5,000,000 to *Nathan* or splits her estate up into twenty bequests of $250,000 each to *Nathan* and nineteen other friends or relatives.

From an equal opportunity perspective, *Moira*'s choice has very different implications. Receiving $5,000,000 drastically alters *Nathan*'s options. He can choose to stop working and travel the world permanently, to use the bequest as substantial seed money for a business, or to make substantial political contributions. In contrast, a bequest of $250,000 will also likely alter *Nathan*'s life, but not to the same extent. Perhaps he pays off his mortgage or buys a lake cottage; maybe he repays his student loans or assists his own child with tuition. He could make small upgrades to his business, or perhaps take some time off of work for several lavish vacations, but likely cannot quit his job altogether.

An accessions tax that applies increasing marginal rates based on a transferee's total cumulative receipts reflects these differences better than an estate tax for two reasons. First, the extent to which a bequest alters *Nathan*'s ability to pursue his life plans depends on the amount received by *Nathan*, not the total amount transferred out by *Moira*. By focusing on the former instead of the latter, an accessions tax better reflects equality of opportunity ideals. Whether *Nathan* receives $5,000,000 or $250,000, the tax burden should depend on what he receives, regardless of whether *Moira* makes additional transfers to other individuals.

That said, the total amount of gratuitous transfers received by *Nathan* over the course of his lifetime – in addition to the bequest from *Moira* – should also affect *Nathan's* tax burden. If *Moira*'s $250,000 bequest to *Nathan* comes a year after he receives a $1,000,000 gift from another relative, *Nathan*'s tax burden should be higher than if *Moira*'s bequest is the only gratuitous transfer he receives. The more *Nathan* receives over the course of his lifetime, the greater the impact on his opportunities. A cumulative accessions tax with increasing marginal rates, rather than either an annual inheritance tax or an inheritance tax based solely on the size of each individual transfer received, encapsulates this intuition. This also precludes *Moira* from simply splitting her transfers to *Nathan* up over time; the impact on *Nathan*'s opportunity (setting aside for now the time value of money) is the same whether he receives one bequest of $250,000 or five gifts of $50,000.

Second, assuming *Moira* is tax-sensitive, an accessions tax contains incentives for *Moira* to divide her estate into a greater number of smaller transfers rather than a fewer number of larger ones. This is so because each recipient will have his or her own exemption level and trip up the progressive rate schedule. Consider the following rate schedule:

Cumulative Amount of Transfers Received	**Tax**
$0 to $250,000	0
$250,000 to $500,000	20% on amount above $250,000
$500,000 to $750,000	$50,000 plus 30% on amount above $500,000
$750,000 to $1,000,000	$125,000 plus 40% on amount above $750,000
Over $1,000,000	$225,000 plus 50% on amount above $1,000,000

In this hypothetical rate structure, each recipient has a lifetime exemption of $250,000. Assume that the recipients of *Moira*'s largesse have received no other gratuitous transfers. By splitting her estate into twenty bequests of that amount, *Moira* could hypothetically avoid tax on her transfers. In contrast, if she leaves one $5,000,000 bequest, she'll be taxed on transfers of $4,750,000.

Of course, *Moira*'s transfers will not be tax-free if the recipients have already exceeded their individual exemption amounts. As long as the recipients have not yet reached the top rate, however, *Moira*'s transfers will trigger less tax if split up among many individuals because each recipient gets their own trip up the rate ladder. Assume, for example, that she leaves 20 bequests of $250,000 to individuals who have each already received $250,000. The total tax will be $1,000,000 (20% of $250,000, or $50,000, for each of the twenty recipients). Next consider what happens if she leaves $5,000,000 to one person who has already received $250,000, meaning that they have already used up their zero rate and the first dollar of this transfer will be taxed at a rate of 20%. In this case, the total tax will be $2,350,000. ($50,000 on the first $250,000; $75,000 on the amount between $250,000 and $500,000; $100,000 on the amount between $500,000 and $750,000; and $2,125,000 on the remaining $4,250,000).

A cumulative accessions tax also better reflects equality of opportunity than including gratuitous transfers in one's income.[97] In a cumulative accessions tax, the tax burden increases as one's gratuitous receipts increase, reflecting the notion that the greater the gratuitous transfers received, the greater one's opportunities increase. In contrast, having recipients include such receipts in their income does not reflect this concept, for their tax burdens would turn in part on their other sources of income. Consider two heirs who each inherit $1,000,000. Due to the income tax marginal rate structure, *Oliver*, who also has salary income of $500,000, will face a larger tax burden on his inheritance than *Penelope*, who only has salary income of $100,000. If the goal is minimizing gratuitous transfers of wealth, why should the tax burdens of two heirs differ based on their earned income? Moreover, the annual nature of the income tax means that tax could be

[97] For a thoughtful discussion of such a system based on welfarist ideals, see Batchelder, *supra* note 2.

minimized simply by splitting transfers up over time, in order to take advantage of multiple trips up the rate schedule.

2. *Structural Details*

Anne Alstott has offered the most comprehensive exploration of an accessions tax designed specifically to further equality of opportunity ideals to date.[98] As she discusses, it would contain three additional features generally not found in other accessions tax proposals. First, in contrast to most past proposals and the current estate tax, an accessions tax based on equality of opportunity would not contain generation-skipping penalties. Consider a grandfather who leaves $1,000,000 to his son, who enjoys the income but later leaves the $1,000,000 principal to the grandson. Here, two people – son and grandson– enjoy the increased opportunities the $1,000,000 brings, and tax should therefore be imposed twice. But if grandfather leaves the $1,000,000 directly to the grandson, "skipping" his son, only one person – the grandson – enjoys increased opportunities. Thus, only one level of tax is appropriate, not two.[99]

In contrast, if the goal of the estate tax or an accessions tax is to act as a periodic levy on wealth in order to slow its accumulation, then taxes should be imposed at regular intervals regardless of how many times it is transferred. In that case, a generation-skipping penalty may be warranted, so that grandfather cannot minimize the family's taxes by skipping the son.[100]

Secondly, an accessions tax reflecting equality of opportunity ideals would tax transfers received earlier in life more heavily than those received later in life. If *Oliver* receives a $1,000,000 bequest when he is 21, it will likely alter his life plans more than if he receives that bequest at age 55. At age 21, the bequest opens more educational and career opportunities to him, and provides a large cushion for purchasing his first house and starting a family if he so chooses. By age 55, however, much of his life's path is set and the bequest, although generous, will likely alter his life plans to a lesser extent.[101]

Without any adjustments, however, a graduated accessions tax does precisely the opposite. Due simply to the time value of money, someone who receives a gratuitous transfer later in life will face a heavier tax burden than someone who receives that same bequest earlier in life. Compare *Oliver* (who receives $1,000,000 at age 21) and *Penelope* (who receives $1,000,000) at age 31. Although the bequests are nominally the same, the two differ when the time value of money and the recipient's life cycle are taken into account.

[98] Alstott, *supra* note 2.
[99] *Id.* at 518-19.
[100] *See, eg.*, Andrews, *supra* note 32.
[101] *See* Alstott, *supra* note 2, at 525-26.

Receiving $1,000,000 at age 31 is not the same as receiving $1,000,000 at age 21. Assuming a 5% discount rate, the present value at age 21 of receiving $1,000,000 ten years hence is only $613,913. Without an adjustment, *Oliver* and *Penelope* would pay the same tax, even though what *Oliver* receives is more valuable in equal opportunity terms than what *Penelope* receives. To that end, Anne Alstott has proposed an accessions tax that uses a "look-back" model, where the present value at age 21 of a transfer would be determined, tax calculated, and interest on the deferred payment added.[102] Using the rate schedule above, *Oliver*'s tax bill would be $225,000 and *Penelope*'s would be $137,110 ($84,173.90 tax due on a bequest of $613,913 plus 5% interest, totaling to $137,110).

The third and final unique feature of an accessions tax that reflects equal opportunity ideals is that transfers received from close relatives would be taxed more heavily than those from friends and distant relatives. This contrasts with the structure of most accessions tax proposals and state inheritance taxes (which typically tax the former not at all or less heavily than the latter) and may seem counter-intuitive. If the amount one receives (and the timing of that receipt) is what affects one's life opportunities, why should the transferor matter?

Recall the underlying goal of the equality of opportunity ideal: One's choices – not the arbitrary, chance characteristics of one's birth – should determine life courses; outcomes that differ due to choice but not chance should be tolerated. If *Quinn* toils away while *Rachel* sunbathes, *Rachel* has no right to complain that the fruits of *Quinn*'s labor give her a more comfortable life. An accessions tax built upon these ideas therefore seeks to minimize gratuitous receipts that are arbitrary, the product of chance and not choice. Consider the difference between a bequest from a parent to a child and a bequest from one friend to another. Although neither relationship is solely a product of either choice or chance, chance likely predominates in the familial relationship, whereas choice likely dominates the friendship. In that respect, gratuitous transfers received from those with whom one has built a relationship by choice – such as friends or distant relatives – are not as much a product of arbitrary chance than gratuitous transfers from, say, one's parents. To that end, the former should be taxed more lightly than the latter.

Of course, the foregoing discusses only a few features of an accessions tax designed to further equality of opportunity ideals.[103] Even this brief sketch, however, illustrates how the underlying normative reason for taxing wealth transfers should influence the design of that tax.

[102] *Id.* at 521-27.
[103] For a fuller account, see Alstott, *supra* note 2.

B. The Limits of Tax Policy's Impact on Equality of Opportunity

Although the foregoing may sound appealing to resource egalitarian theorists in practice, its real-world impact on equality of opportunity principles is limited for a number of reasons. Consider the various types of advantages that parents with financial resources pass along to their children: Some parents transfer directly to them large sums of money, enough to start a business they otherwise would not or to live a life of leisure (let us call these children the "ultra-advantaged"). Other parents do not directly transfer huge amounts of assets to their children, but instead fund a variety of programs for their children that enable them to develop their talents and abilities: tutors, music lessons, private school, college and graduate education, help with down payments, and so on. (We will call these the "merely advantaged.").

Focus first on the former, whose numbers are fairly low. Could a well-designed accessions tax catch these types of transfers? For the most part. Consider the valuation and administrative problems discussed above in connection with an annual wealth tax. Although a well-designed accessions tax could not erase such difficulties completely, it could minimize them (for example, by requiring attribution of family members' interests when determining discounts). At worst, they would be no greater than under the current estate tax – somewhat of a sieve, but not large enough to undermine the whole system.

That said, although large gratuitous transfers among ultra-advantaged families contribute to the pulling away of the very high end from everyone else, these types of transfers are not the main drivers of inequality of opportunity. Revenue needs aside, what Paris Hilton and her ilk do with their lives does not greatly impact the life opportunities of others without such resources. Taxing such transfers therefore reflects equality of opportunity ideals by doing some leveling down, but does little to bring the disadvantaged to the starting line.

In contrast, consider how the activities of the merely-advantaged do impact the life opportunities of children without similar resources. The high school student whose parents pay for expensive sports camps in the summer has a leg up on a poorer teammate who must work over the summer. Students who take expensive SAT prep classes likewise have an advantage over students who cannot afford such classes when it comes to college admissions. Young couples whose parents help buy their first house can outbid competitors. And so on.

An accessions tax designed to reflect equality of opportunity principles would therefore reach well into the upper-middle classes, perhaps further than it did before the 2001 tax cuts. One complication, as Ed McCaffery has argued, is that when wealth transfers are taxed, individuals may well respond by consuming more. And in the case of upper-middle class families, much of that consumption – private schools, fancy camps, family trips to Europe, and so on – exacerbates inequalities in opportunity.[104] Some would therefore argue that much of the private spending by upper-middle classes on the development of human capital should be taxed.[105] Although others argue that taxing such transfers interferes with liberal ideals concerning the family,[106] set that debate aside and assume that a decision has been made to tax such transfers.

Could that be done? Not without great difficulty – how would an accessions tax system distinguish between allowable support and taxable transfers? Perhaps one could tax the payment of private school tuition (unlike the current system, which exempts such payments from the gift tax system).[107] But what about buying a more expensive house in a neighborhood with good schools? How could a tax system distinguish between hiring a math tutor to give your child an advantage in school and hiring one simply to help them stay afloat? Some might argue that making such a distinction is unnecessary, on the grounds that the ability of some parents, but not others, to help their children stay afloat upsets equality of opportunity ideals. Helping one's child stay afloat, however, strikes many as the very essence of what parents should do. Taxing such expenditures would likely generate unprecedented political opposition on the grounds that so doing interferes in intimate and fundamental family matters.

Crafting a workable distinction between support and providing advantages is therefore necessary but essentially impossible. A second complication is that many of the advantages that better-off parents provide to their children – reading and talking to one's child, providing a stable two-parent family in a safe neighborhood, modeling qualities that help children succeed in school and the workplace -- are not financial and cannot be taxed.

These complications have two implications for designing an accessions tax to reflect equality of opportunity ideals. First, in theory, the inability to distinguish between support and advantages highlights the importance of taxing those types of transfers that most clearly go beyond support. This might include limiting the use of the annual exclusion, which – at $14,000 per recipient per donor – exceeds most families' notions of everyday birthday and holiday gifts. It may also include allowing K-12 and college tuition payments to remain nontaxable gifts (as under current law), but redefining graduate school tuition as outside the norm of familial support and therefore to be a taxable gift.

The second complication is that even if parental spending that conferred advantages could be taxed more broadly, so doing simply limits the head start of the advantaged without necessarily bringing children born to financially-

[104] McCaffery, *supra*, note 2.
[105] *See* Bankman & Shaviro, *supra* note 2, at 512 (discussing the ability of transfer taxes to address the transmission of human capital).
[106] Thomas Nagel, *Liberal Democracy and Hereditary Inequality*, 63 TAX L. REV. 113, 120 (2009).
[107] IRC § 2503(e).

disadvantaged households to the starting line. Both the possibility of increased consumption and the extent of non-financial advantages, however, exacerbate the difficulties of limiting the head start of the advantaged. For policymakers interested in equality of opportunity, these difficulties mean that policies that engage in leveling up – giving children born to poorer families the same opportunities as their wealthier peers – are also necessary to implement these ideals. The following section explores this latter concept of leveling up and its relationship to taxing the wealthy.

C. Progressive Spending Does Not Require Progressive Taxation

In addition to the leveling down with which tax policy is most frequently concerned, many scholars have recognized that fostering equality of opportunity also requires leveling up efforts.[108] In many ways, using policies that level up to fight inequality raises the same tax issues as fighting poverty: both require raising revenue to fund such efforts, and both require closely examining how the tax system incentivizes various behaviors of those on the bottom.[109]

Contrary to what one might think, progressive spending policies do not require progressive tax policies to fund them.[110] Indeed, many Scandinavian countries with generous and progressive spending policies do not have progressive tax policies. Eric Zolt argues that such countries shy away from heavily taxing the rich due to both revenue concerns and fears of exacerbating political opposition to social spending programs that help the poor.[111] Taxing wealth as such more heavily, therefore, is not necessarily a pre-condition to increasing opportunities for the poor, and may hinder such policies by increasing political opposition to government spending. Instead, policymakers who want to fund leveling up efforts would be better served by relying on the insights of the optimal tax literature regarding which tax bases and structures can yield the most revenue with the least distortions. Exploring that literature, however, is beyond the scope of this Essay.

V. CONCLUSION

Taxing wealth is a daunting task. Although nontax scholars tend to speak in general terms about taxing the wealthy to fight inequality, using the tax system to do so requires careful consideration of various normative and practical concerns, some of which are at odds with each other. Certain normative goals (ability-to-pay and wealth concentrations as per se harmful) suggest taxing wealth itself via an annual wealth tax as an ideal solution. Even if such a tax were held

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[108] *See* Alstott, *supra* note 2, at 489-92; Bankman & Shaviro, *supra* note 2, at 512; Zolt, *supra* note 2, at 690-91.
[109] *See* Kamin, *supra* note 4.
[110] *See, e.g.*, EDWARD D. KLEINBARD, WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY 336-71 (Oxford University Press 2015).
[111] Zolt, *supra* note 2, at 643-44.

constitutional, however, it would be hobbled by administrative and valuation concerns. A plausible second-best solution would be to treat death as a realization event (in conjunction with ending the preferential rate treatment for capital gains), thereby closing the loophole that allows unrealized gains held at death to escape taxation. By fixing a widely recognized loophole in the income tax system, such a solution is more politically feasible than other second-best options for taxing wealth per se, such as imposing a separate tax on wealth transfers.

In contrast, the normative concern of equality of opportunity counsels taxing wealth transfers as an ideal matter. A close analysis of this concern, however, demonstrates that a transferee-oriented accessions tax best reflects these ideals, in contrast to the current transferor-oriented estate tax. Because such a tax would be imposed roughly once per generation – not annually – administrative and valuation concerns would play a less prominent role than in a wealth tax. That said, wealth transfer taxes often spur families to engage in greater consumption, much of which may exacerbate inequality of opportunity. This increases pressure on policymakers concerned about equality of opportunity to close loopholes allowing certain direct transfers of financial assets to go untaxed while simultaneously engaging in greater leveling up efforts.