Dear Readers,

Attached to this cover page are two documents that I plan to present during my “Perspectives on Taxation Lecture Series” talk on January 29th.

The first is a draft co-authored law review article that we plan to submit for publication within the next few weeks. This article makes the case for why we think that either a wealth tax or an accrual income tax reform (or both!) are needed to fix the broken state of the existing personal tax system, focusing on the U.S. federal level. As part of my presentation, I will also discuss the somewhat different reasons why I think that these sorts of reforms are also needed at the U.S. state level, and some of the tradeoffs involved in the choice of whether to pursue wealth tax reforms, accrual income tax reforms, or both.

The second is a draft wealth tax reform proposal, designed for the state of California—that I have been working on along with Brian Galle, Darien Shanske, and Emmanuel Saez. I have some hope that a revised version of this proposed reform might eventually become a ballot measure for California, but at the moment you can think of this as being just my ideas for how California might best implement a wealth tax. I will discuss some of the innovative features of this proposed tax reform, and I would very much appreciate any thoughts you might have on how taxpayer’s might try to game the proposed rules and on how the proposed rules might be revised so as to either prevent such gaming or to address any other potential issues.

--David
The U.S. income tax is broken. Due to the realization doctrine and taxpayers’ consequent ability to defer taxation of gains, taxpayers can easily minimize or avoid the taxation of investment income, a failure that is magnified many times over when considering the ultra-wealthy. As a result, this small group of taxpayers commands an enormous share of national wealth yet pays paltry taxes relative to the economic income their wealth produces—a predicament that this Article condemns as being economically, politically, and socially harmful.

The realization doctrine is widely justified as an accommodation made for administrative convenience. Although there have been numerous proposals for current-assessment reforms that would abandon or limit the realization doctrine—including wealth tax reform proposals, accrual income tax reform proposals, and others—most tax policy scholars and commentators have disfavored these reform proposals in favor of reforms that would retain the realization doctrine in full. There are two primary reasons for this. First, current-assessment reforms face administrative challenges such as those related to asset valuation and liquidity. However, these challenges are surmountable, especially when it comes to reforms targeted at the ultra-wealthy. Indeed, recent scholarly work shows how a wealth tax reform can be designed so as to be superior at valuation as compared to the existing U.S. income tax.

This leaves us with the second primary reason for why wealth tax and other current-assessment reform proposals have been disfavored: prior
Tax scholarship has generally assumed that the problems created by the realization doctrine can be fixed on the back end by adjusting the rules that govern taxation at the time of realization. Specifically, most tax policy scholars have favored reform proposals—such as retrospective capital gains taxation, progressive consumption taxation, or more incremental reforms—that would retain the realization doctrine, but that would aim to impose taxes in a way that would erase or reduce the financial benefits of deferral.

However, this Article argues that these future-assessment approaches ignore a crucial additional problem of deferral—political optionality. If there is a many-year or longer gap between when either income is earned or wealth is accrued and when tax is assessed, then any number of things can happen in the interim to undermine the eventual assessment and collection of tax. This Article explains three sets of pressures that tend to erode future-assessment reforms over time—but that current-assessment reforms are relatively resistant to—(1) policy drift and the need for incremental bolstering of tax reforms, (2) the time value of options, and (3) federal budget rules and related political incentives.

As this Article demonstrates, both theory and historical experience reveal that future-assessment reforms are fragile and often fail—and that ultra-wealthy taxpayers are well aware of this. In other words, accounting for the implications of political optionality, only current-assessment reforms are likely to succeed at meaningfully taxing the ultra-wealthy and fixing the personal tax system. Hence, we must tax now, or risk taxing never.
INTRODUCTION

Larry Ellison, the founder and still largest shareholder of the software company, Oracle, has a net worth in the neighborhood of $72 billion, making him the fifth richest person in the world. He has used this wealth to, among other things, build a $270 million yacht and a $200 million home (one of many), and buy the Hawaiian island of Lanai for $300 million. Of course, it is not surprising that a person with wealth like that spends it accordingly—except that Ellison famously has sold very little of his Oracle stock. And for a long time, he had base salary of only $1 per year as CEO of Oracle. He instead fuels this consumption out of a $10 billion personal credit line.

Why would one of the richest men in the world take on such debt? Selling just a fraction of his stock would pay for all of his purchases and more. The simple answer is: taxes. At today’s capital gains rates, selling the stock necessary to cover that potential $10 billion of spending would mean cutting a check to the government for over $2 billion. Instead, Ellison is taking advantage of one of the most powerful tax avoidance strategies that exists—simply not realizing gain. Ellison, or his estate, will eventually

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8 There may be non-tax reasons at play as well, including an interest in maintaining control over Oracle, though as other technology entrepreneurs have shown that can be managed in other ways.
have to pay any borrowed money back. Nevertheless, by deferring any realization of gain until some theoretical future date, Ellison has at least lowered—or likely wiped out entirely—any tax due.  

The U.S. tax system does a very poor job of taxing the ultra-wealthy. Most Americans predominantly earn wage and salary income, which the U.S. income tax measures reasonably well. By contrast, the ultra-wealthy predominantly earn income that arises from the returns to owning wealth (or that can be made to appear as though it arises from the returns to owning wealth), which the U.S. income tax measures dreadfully. Because the U.S. income tax is so bad at reaching the returns to owning wealth, an ultra-wealthy person could, to a first approximation, earn over $10 billion and spend it on islands and yachts without ever paying income tax.

This deep failure of the U.S. income tax has implications beyond just the windfall for the ultra-wealthy. As we will explain, this state of affairs violates even the minimal fairness requirement that the personal income tax not be regressive. This state of affairs also harms economic efficiency, because the tax gaming techniques that the ultra-wealthy use to lower their tax burdens are wasteful and economically damaging. Further, this state of affairs undermines both the administrability and integrity of the entire U.S. tax system, through the tax system’s struggles to cope with the destructive effects of the ultra-wealthy’s tax gaming. In a sense, the problems caused

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10 See, e.g., Ari Glogower, Taxing Inequality, 93 N.Y.U. L. Rev. 1421, 1424 (2018) (“With these changes, Congress has taken a hammer to a progressive income tax system that was already broken.”); Mark P. Gergen, How to Tax Capital, 70 TAX L. REV. 1, 1 (2016) (“It is well known that the existing system in the United States for taxing capital income is a mess.”); Edward J. McCaffery, A New Understanding of Tax, 103 MICH. L. REV. 807, 920 (2005) (“Taxes on capital are easily avoided and virtually voluntary.”).

As we will elaborate in Part I.A, infra, we use the phrase “ultra-wealthy” to refer to households in the top 0.1% (more or less) of wealth in the United States, a group that is estimated to consist of approximately 175,000 households who collectively own between 15% and 20% of national wealth.


12 Id. at 4-8.


14 See infra Part II.
by the ultra-wealthy’s tax gaming thus “trickle down,” creating harmful complexity, along with traps for the unwary, and resulting inefficiencies and unfairness affecting many ordinary taxpayers.\textsuperscript{15}

But why is the U.S. tax system so bad at measuring the economic income of the ultra-wealthy? The chief reason is that the U.S. income tax is realization-based and consequently allows tax on investment income to be deferred.\textsuperscript{16} Taxpayers have devised techniques—some very simple, some quite complex—for delaying realization of their investment income, so that the tax is not owed in the years in which that income is earned or generated, but is instead assessed only at some future date—or often never. As the economist C. Eugene Steuerle has explained, “[m]ost capital income earned never is taxed at the individual level, in part because assets are often not sold and their gains never subject to income tax, in part because capital income benefits from a long list of tax preferences, and in part because of outright evasion.”\textsuperscript{17}

Many prominent tax reform proposals would seek to eliminate opportunities for reducing or negating these deferred tax liabilities but would retain the realization doctrine—we call these \textit{future-assessment} tax reform proposals. The motivating thought behind these proposals is that deferral need not be a problem, in and of itself, so long as deferred tax liabilities are eventually taxed at high enough rates to eliminate the tax advantages from deferral. For instance, most of the major income tax reform proposals would operate in this fashion, as would most of the major consumption tax reform proposals, as well as most other proposals for what are sometimes called “retrospective” style tax reforms.\textsuperscript{18} The theory is that

\textsuperscript{15} The use of “trickle down” here is a reference (and an admittedly snide reference) to trickle-down economics; see Shu-Chun Susan Yang, \textit{Do Capital Income Tax Cuts Trickle Down?}, 60 NAT. TAX J. 551 (2007).

\textsuperscript{16} We use the term “investment income” to refer to income that can be characterized as being derived from the returns to owning wealth (as opposed to pure wage and salary income and the like), so that tax on this income can be deferred under the rules of the existing U.S. income tax. We use this term instead of the more commonly used term “capital income”, because the term “capital income” is used in disparate and often inconsistent ways by different tax scholars and tax authorities. In particular, much of the income that qualifies for deferral under the existing income tax falls outside of what economists would typically consider to be “capital income.” See, e.g., Victor Fleischer, \textit{Taxing Founders’ Stock}, 59 UCLA L. REV. 60, 61 (2011) (“When structured correctly, founders’ stock allows entrepreneurs to defer paying tax until they sell the stock…”); Victor Fleischer, \textit{Two And Twenty: Taxing Partnership Profits In Private Equity Funds}, 83 N.Y.U. L. REV. 1, 3 (2008) (“By getting paid in part with carry instead of cash, fund managers defer the tax on income derived from their human capital.”).

\textsuperscript{17} Steuerle, \textit{supra} note 13.

\textsuperscript{18} See \textit{infra} Part III.B for discussion of retrospective capital gains tax and progressive
if any future tax would be the present-value equivalent of a current tax (which today it is not), then the timing of the tax ought to be irrelevant.

As we argue here, however, the assumption that a future assessed tax could be as effective as a currently assessed tax is deeply flawed. Instead, to meaningfully tax the ultra-wealthy—and thereby start to repair our broken income tax—*current-assessment* tax reform is required.

By *current assessment* we mean any set of rules that actually collects tax in the same time periods in which income is earned or accrued, or alternatively, in the same time periods as when wealth or spending power is accumulated. Examples include wealth taxes,\(^{19}\) mark-to-market or other accrual income taxes,\(^{20}\) and even consumption taxes implemented along with pre-payment or withholding mechanisms.\(^{21}\)

Central to any current-assessment system is the need to value assets at a point prior to sale or other realization, so that any unrealized gain can be

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19 A wealth tax of course does not tax income *per se*. But most proposals for annual wealth taxes would tax an amount less than the average returns to wealth, and thus can be seen as a way for the government to share in those returns as they accrue. This can be distinguished from one-time confiscatory taxes, such as a (well-functioning) estate tax.


21 For explanation, see *infra* Part III.B.2.
measured and taxed.\textsuperscript{22} It is partially because of this need for asset valuation that most tax policy scholars and tax reform advocates have disfavored current-assessment reforms.\textsuperscript{23} While the realization doctrine has historical roots in outdated notions of what can be considered “income” conceptually and for purposes of the 16\textsuperscript{th} Amendment,\textsuperscript{24} the standard view today is that realization is a necessary evil because it is difficult to do annual valuations of relatively illiquid assets, such as shares in private corporations, partnership interests, real estate, and artwork.\textsuperscript{25}

These valuation and related problems present real and difficult challenges, to be sure. However, these challenges are surmountable, especially with regard to current-assessment reforms targeted at only the ultra-wealthy. Indeed, recent scholarly and law-reform work shows how current-assessment reforms can be designed so as to be superior at valuation as compared to the existing U.S. income tax.\textsuperscript{26} In any case, there are a


\textsuperscript{23} See, e.g., Miranda Perry Fleischer, Not So Fast: The Hidden Difficulties Of Taxing Wealth, 58 NOMOS 261, 262 (2017) (“Not only is an annual wealth tax susceptible to constitutional challenges, for example, but such a tax would be hobbled by valuation issues.”); Kamin, supra note 18, at 123 (“The problem—one of several long-standing objections to mark-to-market accounting and annual wealth taxes—is valuation.”); James R. Repetti, Commentary: It’s All About Valuation, 53 TAX L. REV. 607, 608 (“[V]aluation, which is the major difficulty in achieving an ideal income tax that periodically measures accretions to wealth is also the major difficulty in achieving an ideal wealth tax.”).


\textsuperscript{25} David M. Schizer, Realization as Subsidy, 73 N.Y.U. L. REV. 1549, 1552 (1998) (“[Realization] is typically justified as a necessary evil, in that alternatives—such as taxing unrealized gains … are not administrable or politically feasible.”).

\textsuperscript{26} David Gamage et al., Valuation and Measurement for a Wealth Tax Reform, Roosevelt Institute Report (unpublished draft report on file with authors, expected publication in March 2021); David Gamage & John R. Brooks, Building Better Wealth Tax and Accrual Income Tax Reforms (incomplete draft manuscript on file with authors); David Gamage, supra note 22, at 14–16.

Also, one of us (Gamage), has recently co-drafted both a proposed wealth tax current-assessment reform bill for the State of California and a mark-to-market current-assessment reform bill for the State of New York, both of which incorporate some innovations (that we will explain more fully in future scholarship) for mitigating concerns related to valuation and liquidity; see AB-2088 WEALTH TAX, AMENDED IN ASSEMBLY AUGUST 13, 2020, CALIFORNIA LEGISLATURE—2019-2020 REGULAR SESSION, available at https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB2088 (Sections 50307-50309 contain our valuation innovations, and Subsection 50307(c) contains our liquidity innovations); David Gamage, Emmanuel Saez, and Darien Shanske, The California Extreme Wealth Tax: Revenue, Economic, and Constitutional Analysis
number of prior proposals that we think would do a sufficiently decent job of mitigating these challenges while enacting reasonably effective current-assessment reforms.\textsuperscript{27} The point being that solutions to these problems exist, even if these solutions are not perfect. These proposals have different strengths and weaknesses, and fully evaluating the advantages and disadvantages of the various existing proposals for current-assessment reforms is beyond the scope of this Article. Instead, this Article argues that we should adopt one of these proposals, or else develop better ones, because a current-assessment reform is necessary to fix our broken income tax. We must tax now, or else risk taxing never.

Current-assessment tax reform is needed because the U.S. political system is not up to the task of maintaining comprehensive and sufficient taxation of deferred tax liabilities long enough to actually collect that tax sufficiently in the future. Allowing an extended time between passing a reform and actually collecting tax opens up too many opportunities for administrative maneuvering, for the development of new avoidance techniques, for a change in fundamental economic conditions, or for simply waiting for a change in political power.

Put another way, it is entirely plausible that a new governing coalition might be elected at some point in the coming years with sufficient votes to enact a major tax reform with the goal of fixing how the existing tax system is broken with respect to the ultra-wealthy. But if that is a future-assessment reform, it is implausible to expect that this coalition would remain in power long enough, while maintaining sufficient commitment to bolstering its tax reform throughout, to prevent new opportunities from emerging in the future for taxpayers to negate or reduce their deferred tax liabilities. We argue that the most likely outcome is an incremental weakening of the reform in the face of these forces, perhaps culminating in outright repeal after a shift in political power.\textsuperscript{28} And this process is made easier because a future-assessment reform that has yet to collect much revenue is distinctly


\textsuperscript{28} See \textit{infra} Subsection III.A.1.
disadvantaged politically and budgetarily. 29

To clarify this argument, we distinguish here between two benefits of deferral. Almost universally when the prior literature has referred to the tax benefit of deferral, that literature has considered only the benefits baked into existing law. These include, for example, taking advantage of the time value of money by delaying realization or waiting for the Section 1014 step-up in basis. But the literature has mostly ignored a second benefit of deferral, which we refer to as the political optionality benefit of deferral. 30 In short, deferring the point at which the law imposes tax gives taxpayers time and opportunity to wait for the law to weaken or change—or even to lobby for such a change.

History shows time and again that ultra-wealthy taxpayers are well aware of the limits of the U.S. political system and can thus be expected to defer their tax liabilities while waiting for future opportunities to permanently negate or reduce their deferred tax liabilities. 31 Thus, it is not enough to continue to rely on realization to trigger taxation in the future while hoping to impose a present-value equivalent tax at that time. Unless some as-of-yet unknown mechanism can be created to prevent new opportunities for reducing or negating deferred tax liabilities from arising in the future, no tax reform that permits deferral will succeed at fixing how the personal tax system is broken.

This Article elaborates three sets of pressures that tend to undermine future-assessment reforms over time, but that current-assessment reforms are relatively resistant to. The first set of pressures arises from policy drift and the need for incremental bolstering of major tax reforms. For a number of reasons, the nature of tax politics creates asymmetric pressures that tend to push toward undermining tax reforms—especially reforms targeted at the ultra-wealthy. Consequently, it is crucial that as many key mechanics of a major tax reform as possible be implemented at or immediately following the time of the reform’s enactment, while the initial reform coalition still retains its strength and commitment to the reform. Because future-assessment reforms put off the actual assessment and collection of tax, such reforms also put off the time when key administrative decisions and technical corrections are made, making it dramatically more likely that the

29 See infra Subsections III.A.3–4.
30 Important exceptions to this, especially in the context of current tax reform discussions, include David Kamin and Jason Oh, The Effects of Capital Gains Rate Uncertainty on Realization, UCLA Law & Economics Research Paper No. 19-06 (2019), and Daniel Hemel, Taxing Wealth in an Uncertain World, 72 Nat’l Tax J. 755 (2019). We have been aided in this project from these papers and our conversations with the authors.
31 See infra Section III.C.
reform will be substantially undermined over time.

The second set of pressures arises from the time value of options. Future-assessment reforms give taxpayers the choice of when to realize their tax liabilities—when to exercise the option value of deciding in which future political regime a deferred tax liability will be realized, assessed, and paid. This creates strong incentives for ultra-wealthy taxpayers both to wait for (favorable to them) future legal or political changes and to lobby and exert other political pressures in the hopes of creating such future changes.

The third set of pressures arises from federal budget rules and resulting political incentives. For federal budget scoring purposes, much of the tax revenue that might theoretically be raised by a future-assessment tax reform will show up outside of the budget window. This makes it much more politically difficult to legislate bolstering and strengthening such reforms while making it much easier politically to legislate weakening such reforms.

This Article proceeds first (in Part I) by further clarifying how the existing U.S. income tax is broken, then (in Part II) by arguing that this brokenness creates serious unfairnesses and inefficiencies that weaken the entire existing tax system and that motivate our call for reform, and finally (in Part III) by explaining the three sets of pressures that tend to undermine future-assessment reforms—but that current-assessment reforms are relatively resistant to—developing these explanations based on theory as well as by examining both specific future-assessment reforms and the history of prior reform attempts.

I. THE INCOME TAX IS BROKEN

A central motivation of this Article is that taxation of the ultra-wealthy is both necessary and currently inadequate, and furthermore that this failure to tax the ultra-wealthy is a systemic problem that undermines the overall income tax. The problem is not merely that some rich people get marginally richer. Rather, the manner in which the tax system benefits the ultra-wealthy reveals core problems and threatens the integrity of the tax system itself.32

In this Part we begin with a description of the ultra-wealthy and the

32 Of course, the failure to tax the ultra-wealthy is not the only way in which the existing U.S. tax system is broken. For instance, we consider important aspects of the business-level tax system to also be broken. However, we will argue that the manner in which the existing U.S. personal income tax is broken with respect to the wealthiest individuals and families makes it harder to mend other ways in which the existing tax system is broken, so that fixing how the personal tax system is broken with respect to the ultra-wealthy is a good starting point for reform.
nature of their income and wealth. The key point is that “[t]hey are different from you and me”\textsuperscript{33} in the ways that they earn income and acquire wealth, and therefore how they interact with the tax system. Based on those differences, we then turn to how the income tax is broken. The income tax system does a reasonably good job of taxing wages and other regularly earned income from labor, but does a very poor job of reaching the returns to wealth and other stores of financial capital.\textsuperscript{34} (Readers already familiar with how investment income is currently only scantily taxed may wish to skip or skim this Part.)

\textbf{A. Who Are the Ultra-Wealthy?}

The focus of this article is on the taxation of a particular subgroup of American taxpayers that we label as the “ultra-wealthy.”\textsuperscript{35} By this we mean tax households in the top 0.1\% (more or less) of wealth in the United States.\textsuperscript{36} This is, to be clear, a relatively small group—approximately 235,000 individuals\textsuperscript{37} or 175,000 tax households.\textsuperscript{38}

So, who are they and what does their financial picture look like? We should say at the outset that comprehensive and reliable data on wealth


\textsuperscript{34} Batchelder & Kamin, supra note 11, at 4 (“Wages comprise the vast majority of income for those outside of the top 1 percent of income… Tax avoidance and evasion are rare for wage income because it is subject to information reporting and withholding, and because wage earners generally cannot manipulate the timing of income recognition…”).

\textsuperscript{35} We describe this Article’s project and narrow its focus in this way because we are abstracting here from larger questions about the proper tax base(s) for a tax regime as a whole; our question here is on the particular tools and policies needed to meaningfully tax this small group of taxpayers, regardless of how the remaining tax system is constituted. Indeed, as we will argue, due to the way the wealth and income of this group is derived, any modern tax system must consider the issues we raise if it wishes to successfully tax this group. That is, regardless of whether a country as a whole chooses to tax income, wealth, consumption, or some other measure for economic well-being, or some mixture of these, we believe that successful taxation of the ultra-wealthy requires use of a current-assessment mechanism (as we will argue in Part III).

\textsuperscript{36} Over time, the top taxpayers by wealth will roughly correspond to the top taxpayers by income, but income-based measurements tend to fluctuate more over time as compared to wealth-based measurements, so that the top taxpayers by income in any particular year will correspond less with the top taxpayers by wealth as compared to considering the top taxpayers by income across a longer time frame.


distribution is thinner than for income. Much of the information we have is from government surveys, which have some weakness in tracking some forms of privately-held wealth and attributing them to individuals.\(^{39}\) That said, we can still know to a reasonably high degree of certainty that certain types of wealth are held by the class as a whole, even if we can’t assign it to particular individuals.

Let’s begin with the top 0.1% of households in terms of wealth (rather than in terms of income or consumption). In a recent paper, Emmanuel Saez and Gabriel Zucman, two of the leading economists studying income and wealth inequality, use a range of methodologies to estimate that these 175,000 households own between 15% and 20% of national wealth, with a minimum wealth of at least $25.5 million per household.\(^{40}\) Because these levels are estimated using a variety of methods, including estate tax data, the Survey of Consumer Finances (SCF), and the Forbes 400 list, we cannot say precisely what the income composition of this group is. But we can instead look at the 0.1% of households in terms of income, which is likely to have substantial overlap with the top 0.1% of wealth-holders. For this group, the largest single income component is capital gains, and the combination of capital gains, business income, and other forms of investment income (like interest and dividends) makes up roughly 70–75% of their total income.\(^{41}\)


\(^{40}\) Saez & Zucman, supra note 39, at tbl. 2. Although there has been some debate about other estimates made by Saez & Zucman, most notably their revenue estimates for wealth tax proposals and their estimates for the overall distributional incidence of the entire tax system (see note __ infra), their estimates that we report above seem to be in a similar range to corresponding estimates made by other notable economists. For instance, Smith, Zidar, & Zwick, supra note 40, report that there are approximately 234,600 individuals in the top 0.1%, and that these individuals control approximately 15.1% of national wealth, with a minimum wealth of approximately $16 million per individual.

\(^{41}\) See, e.g., Thomas Piketty, Emmanuel Saez & Gabriel Zucman, Distributional
The balance of wage income and investment income in the earnings of the ultra-wealthy has varied over time. In the last period of dramatic wealth and income inequality during the 1920s, salaries made up an even smaller share of the income of the ultra-wealthy than today. In the immediate post–World War II period, investment and business income were relatively low, and so salary income made up a larger relative share of income. When inequality started to grow again in the late 1970s and 1980s, salary income was a big driver, leading some researchers to speculate that “superstars”—those who could demand huge payments for their skills, such as athletes, actors, and CEOs—were driving the increase in inequality. Since 2000, however, financial investment income, especially capital gains, has returned with a vengeance. Today we can comfortably say that the vast majority of the income of this ultra-wealthy group is earned from their financial capital rather than their human capital.

If we narrow further to examine the top 0.01% of wealth-holders, these 17,500 households own wealth of at least $120 million per household, with an average wealth of around $365 million. Saez and Zucman estimate using SCF data that the reported income of this group averages $11.6 million annually, but they say that is under-reported by about 50% given typical returns on wealth. We can safely assume that all or nearly all of the under-reported income is from investment, given typical avoidance and evasion strategies. Moreover, given these wealth levels, we can reasonably assume that the income generated by that wealth swamps whatever these taxpayers might be earning from salary or wages.


43 To be clear, portions of measured capital gains and returns to wealth holdings may result at least in part from these taxpayers’ labor efforts (think, for instance, of a superstar investor like Warren Buffet skillfully selecting stocks). Nevertheless, the key point for our purposes is that most of the economic income of the ultra-wealthy is earned in forms that our existing tax system deals with very poorly, rather than in the form of salaries and wages which our existing tax system deals with quite successfully.

44 See Saez & Zucman, Progressive Wealth Taxation, supra note 38, at tbl.3.

45 Even a relatively modest 3% return on wealth of $345 million would generate $10,350,000 of income in a year. Only in extreme cases does labor income approach that level.
Ultimately, then, the story of the ultra-wealthy is a story of (a) enormous holdings of wealth and (b) the dominance of income from that wealth—that is, investment income—over income from salaries and wages. These first-order facts make the ultra-wealthy different from the vast majority of taxpayers, who generally have low or even negative wealth and who earn virtually all of their income from salaries and wages.

B. How the Income Tax is Broken

The income tax is broken because of its reliance on realization—that is, that most income from the appreciation of assets is only taxed when it is realized through a sale or exchange of those assets. For most taxpayers, realization is of little import, since they have few appreciated assets, and what they have is already shielded from taxation anyway. But for the ultra-wealthy, whose income comes via the accumulation of financial assets, realization is central.

Because of the realization-based nature of the income tax, the ultra-wealthy—though not only them—can take advantage of tax planning strategies that defer and then reduce or even wipe out the personal-level tax on investment income. Some strategies for accomplishing this are sophisticated and aggressive, especially the use of offshore funds. But even relatively simple strategies can be very effective. We describe them below to illustrate that the income tax’s failure to tax the ultra-wealthy is based not (only) on obscure financial engineering, but rather on basic, core features of the income tax that have been with us for over 100 years.

1. Strategy 1: Defer Realization of Gains

The simplest strategy of all is to simply not sell any appreciated assets—and to thereby not realize any taxable investment income from those assets—at least for a time. The income tax applies only to realized

46 See, e.g., I.R.C. §§ 501(a) (exempting, inter alia, qualified pension plans from taxation), 121 (excluding from gross income up to $500,000 of gain from the sale of a principal residence).

47 For a relatively easy to understand explanation of how this works, see Matt Levine, Taxes, Hedge Funds and an Incident, BLOOMBERGVIEW, Dec. 30, 2015, (“That's the basic idea of the ‘income defense industry,’ just finding places to point money-generating machines that won't generate present taxation. That's how the Bermuda-reinsurance thing works; it transforms a money-generating machine (a hedge fund) from immediate income into capital appreciation.”), available at http://www.bloombergview.com/articles/2015-12-30/taxes-hedge-funds-and-an-incident.

48 Investment income can also come from dividends, interest, and similar payments that don’t benefit from the realization rule. However dividends in particular are
gains, and so avoiding realization means avoiding tax on that investment income. To be clear, the appreciation in an asset is economic income regardless of whether the asset is sold or not.\textsuperscript{49} But because the income tax only recognizes the income upon a sale, reported investment income, and resultant taxes collected, dramatically understates the amount of true economic income taxpayers derive from investment.\textsuperscript{50} Even though market investment returns are generally in the range of 7 to 8 percent (and likely higher for the ultra-wealthy\textsuperscript{51}), reported taxable returns of the ultra-wealthy are around 1 to 2 percent.\textsuperscript{52} We can thus estimate that most ultra-wealthy taxpayers only ever realize as taxable income less than a quarter of their true investment income.\textsuperscript{53}


\textsuperscript{49} See, e.g., HENRY SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938).

\textsuperscript{50} As is typical in the academic tax literature, we use the terms “true” income, “real” income, and “economic” income— all interchangeably—to refer to Haig-Simons income (which includes unrealized appreciation). For elaboration, see Edward J. McCaffery, \textit{Taxing Wealth Seriously}, supra note 2, at 314–17.

\textsuperscript{51} See C. Eugene Steuerle, Taxes, Government Transfers and Wealth Inequality, THE MILKEN INSTITUTE REVIEW, First Quarter 2019 18–20 (“The tendency to accrue capital gains but not expose them to taxation is especially relevant for those who accumulate great wealth. On average, they (or some ancestor) became rich by performing two somewhat uncommon acts. First, they saved (or invested through borrowed dollars) a much larger than average share of their income. Second, they achieved returns on their net investments that were well in excess of the average real rate of return of 6 or 7 percent enjoyed by the typical stock investor.”).

\textsuperscript{52} Jenny Bourne et al., \textit{More Than They REALIZE: The Income of the Wealthy}, 71 NAT’L TAX J. 335, 336 (2018) (“Taxable returns to capital in our sample were even lower; in the aggregate, taxable returns were less than 3 percent and the predominant rate was in the 1 to 2 percent range.”).

\textsuperscript{53} Id. at 352 (“Consider individuals who received a 7 percent real return [and even higher nominal return] on their capital in the long term. Assume that for tax purposes they are among the majority shown here who reported taxable income of only 2 percent or less.”). For a discussion of the anecdotal and more inferential evidence supporting that this estimate, see McCaffery, \textit{Taxing Wealth Seriously}, supra note 2, at 329–31. Using more conservative assumptions, Saez and Zucman estimate that “top wealth holders have a fiscal income that is slightly less than half of their true economic income (defined as wealth times the average macroeconomic return to wealth).” This estimate is larger than the $2/7$ estimate from Bourne et al., \textit{id.}, both because Saez and Zucman use more conservative estimates for the share of wealth reported as taxable income and because they then multiply
Moreover, it is well-understood by tax scholars, analysts, and others—including the ultra-wealthy themselves—that even just deferring the realization of investment income lowers the effective tax rate on that income. This is because deferring tax on investment income allows the taxpayer to keep and continue to earn returns on what would otherwise have been the taxes paid.\textsuperscript{54} Thus, even to the extent that a taxpayer eventually does pay tax, she still keeps the after-tax profits from that interim investment—the taxpayer literally can generate additional after-tax income just by deferring tax payments.\textsuperscript{55}

2. Strategy 2: Never Realize Gains

Deferring gains generates a tidy return for owners of wealth even if eventually a gain is realized and taxes fully paid. But we can go further, this by “the average macroeconomic return to wealth” (which is lower than the 7 percent real return estimate used by Bourne et al.); Saez & Zucman, Progressive Wealth Taxation, supra note 38, at 20. Because Saez and Zucman purposefully err on the side of caution in the sense of biasing their estimates to the low end of the plausible range, we think the Bourne et al. estimates are probably more accurate, but this difference is not especially important for this article’s purposes. Consider Steuerle’s discussion in Individuals Pay Very Little Individual Income Tax on Capital Income, supra note 13, “[the Bourne et al. estimates] are similar to what I found in a study covering the more inflationary 1970s. In yet another study, I found that a select group of owners of businesses and farms subject to estate tax reported even lower taxable returns. And in a book published in the early 1980s, I showed how net income from capital reported on all individual tax returns was less than one-third of total capital income in the economy. Keep in mind, regardless of what they report on tax returns, top wealth holders often achieve very high actual returns on their assets. The merely wealthy commonly earn stock market returns of 7 to 10 percent per year, while truly rich investors often attained that status by earning even more. Warren Buffett revealed in one income tax return that he recognized only about 1/50 of 1 percent of his wealth as taxable income even though his primary asset, Berkshire-Hathaway stock, had been earning about 10 percent annually.”

\textsuperscript{54} To see this simply, suppose a person has some income in Year 1 that would generate a tax $T$ if paid in Year 1. If instead, the person could defer paying $T$ until Year 2, that would be the present value equivalent of $T/(1 + r)$ in Year 1, where $r$ is the standard discount rate (e.g., a risk-free rate of return). The intuition is that the person could invest $T/(1 + r)$ in Year 1 to generate $T$ in Year 2 and then pay the tax owed. If the person could defer paying the tax for $n$ years, the present value of the tax becomes $T/(1 + r)^n$, and thus approaches zero as $n$ gets larger. For example, if the Year 1 tax would have been $100, but can be deferred for 20 years, and the discount rate is 5%, the present value of the tax becomes just $38—a person only needs to set aside $38 in Year 1 rather than $100.

\textsuperscript{55} Continuing the example in the prior footnote, another way to see the intuition is that the $100 of deferred tax could grow to $265 in 20 years if invested at a 5% return. In 20 years, the person would still have to pay the original $100 tax, plus a share of the $165 in growth—but they would still be left with $165(1 − 𝑡)$ after taxes.
following not selling with never selling—that is, passing appreciated assets to heirs at death. At that point, our tax law allows a “step up” in basis to the assets’ fair market values.\footnote{I.R.C. § 1014.} This wipes out any unrealized, built-in gain in the assets when they pass to the taxpayer’s heirs.

For the ultra-wealthy, who often do not consume more than a small fraction of their wealth during their lifetimes, this is especially important—the tax law essentially subsidizes the accumulation of large, dynastic wealth. In theory, the estate tax was intended to mitigate this, by taxing the transfer of wealth at death.\footnote{Edward J. McCaffery, Taxing Wealth Seriously, supra note 13, at 326 (“the gift and estate or unified wealth transfer tax system is not taxing wealth seriously. The estate tax has long been essentially a ‘voluntary tax,’ as it was dubbed in 1977. It is easily avoided with fairly standard planning techniques.”).} But sophisticated estate planning techniques and political erosion of the tax itself means that the estate tax today is just something else to be planned around, with minimal impact on wealth accumulation.\footnote{Edward J. McCaffery, Taxing Wealth Seriously, supra note 13, at 326 (“the gift and estate or unified wealth transfer tax system is not taxing wealth seriously. The estate tax has long been essentially a ‘voluntary tax,’ as it was dubbed in 1977. It is easily avoided with fairly standard planning techniques.”).}

3. Strategy 3: Consume from Untaxed Gains

But what about the share of wealth that a taxpayer does consume during her lifetime, and thus cannot be passed to heirs? Again, there are relatively simple strategies to reduce or negate the effective tax on any investment income that is used to fund consumption. To begin with, the taxpayer could engage in “tax-loss harvesting,” which simply means offsetting any realized gains with realized losses, so as to reduce or negate the net capital gains tax.\footnote{See e.g., Eric D. Chason, Taxing Losers, 18 FLA. TAX REV. 541, 545 (2016).} For a wealthy taxpayer with a diverse portfolio, there will likely always be at least some losses to selectively realize, even when the portfolio as a whole is well in the black.\footnote{Plus, sophisticated taxpayers often go further to engage in tax-loss “farming,” which involves planning investments in advance so as to increase the likelihood that there will later be sufficient losses for tax-loss harvesting, and without significantly reducing the expected return on the entire investment portfolio. See e.g., Fidelity Viewpoints, How to invest tax-efficiently: Create a strategy to help manage, defer, and reduce federal taxes. FIDELITY (Jan. 31, 2020), https://www.fidelity.com/viewpoints/investing-ideas/tax-strategy.} Due to advances in financial technology and the rise of “robo-advisers,” these strategies are now widely available and used even by retail investors.\footnote{See, e.g., Shomesh E. Chaudhuri, Terence C. Burhnam, and Andrew W. Lo, An Empirical Evaluation of Tax-Loss-Harvesting Alpha, 76 Fin’l Analysts J. 99, 99–100 (2021).}
Going further, the taxpayer can engage in what Edward McCaffery has called the “buy, borrow, die” strategy.62 If an ultra-wealthy taxpayer needs more money to fund consumption than can be generated through tax-loss harvesting, she can simply borrow that money, pledging the appreciated assets that she earlier bought (or created). This borrowing typically comes at some cost, but at current interest rates (especially from a bank that is probably very happy to have other business from the ultra-wealthy and their businesses), that cost can be very low, especially relative to the tax cost of realization. Moreover, the debt can then later be paid back after death by selling assets that, at that time thanks to section 1014, can be sold without generating any taxable income.63 The overall result is a complete negation of all income tax on investment income, even if that income is transformed into cash to fund consumption.

4. Other Strategies

Section 1014 and its step-up in basis at death are not the only way to wipe out tax on investment income entirely. Another major tool is the ability to donate appreciated assets to charity—including to the taxpayer’s private foundation—and to thereby get a deduction for the full fair market value without having to realize any capital gain on those assets. Of course, in this case the wealth also leaves the person’s hands as a legal matter. But if the cash is held by a private foundation the donor can still spend that wealth on the matters and issues they care about, without ever paying any income tax on that wealth as it accumulated. Moreover, by combining this strategy with valuation-based gaming, many ultra-wealthy taxpayers succeed in cancelling out tax on much larger amounts of income than just the assets donated to charity.64

The strategies go on and can become much more sophisticated, and often more aggressive, sometimes crossing the line to become outright tax evasion, for example through marketed tax shelters and the like.65 But, at

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62 McCaffery, Taxing Wealth Seriously, supra note 13, at 306.
63 See supra notes 1–9 and accompanying text.
65 See, e.g., David Gamage, The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth, 68 Tax L. Rev. 355, 364–65 (2014) (“There are numerous variations on these sorts of distortionary responses, and they can often be very complicated—especially when the responses take advantage of partnership tax rules or the rules governing the taxation of financial products.”); Del Wright Jr., Financial Alchemy: How Tax Shelter Promoters Use Financial Products to Bedevil the IRS (And How the IRS
base, these strategies nearly all rely on deferral in one way or another—
devising techniques for the ultra-wealthy to defer realizing net capital gains,
and ideally to defer any realization enough into the future that any gain can
ultimately be wiped out.

To be clear, strategies for negating tax on investment income are not
limited to the ultra-wealthy. Indeed, many banks and investment advisors
now market “securities-backed lines of credit” to the merely rich as well, to
make the “buy, borrow, die” strategy explained above more accessible.66
But what separates the ultra-wealthy for our purposes is not just that they
have access to particularly sophisticated investment and tax strategies
(though they do), but rather the overwhelming dominance of investment
income as a share of their total income—this fact makes even these plain-
vanilla strategies especially powerful and dramatically lowers the effective
tax rate on their total income.67

Ironically, the ability for taxpayers to easily reduce the amount of their
investment income subject to tax is also the primary justification for why
we have lower tax rates on capital gains than on ordinary income. If the tax
rate were higher, taxpayers would be expected to engage in even more tax
planning and realize even fewer gains, such that tax revenue could drop.68
Due to these preferential rates, average tax rates on reported income of the
top 0.1% are actually lower than they are for the next richest cohort,69
and this is even before we account for the tax benefit of using deferral to avoid
reporting other income.

One advantage of investment income thus begets a second advantage,

66 See, e.g., Jordan Wathen, Wall Street’s Hottest Loan Product: Borrow Against Your

67 See supra note 52.

68 See, e.g., Batchelder & Kamin, supra note 11, at 14 (“That is, above a tax rate on
capital gains of roughly 30 percent, the Treasury would begin to lose revenues because
taxpayers would respond by deferring realizing gains for much longer periods of time.”); McCaffery, Taxing Wealth Seriously, supra note 2, at 331-34.

69 Internal Revenue Service, Statistics of Income, Number of Returns, Shares of
Adjusted Gross Income (AGI) and Total Income Tax Rates, tbl. 1 (Oct. 2018), available at:
Internal Revenue Service, The 400 Individual Income Tax Returns Reporting the Largest
largest-adjusted-gross-incomes; Batchelder and Kamin, supra note 11, at 4.
compounding the preferences for the ultra-wealthy. As we will elaborate, below, this is a key aspect of how the manner in which the personal income tax is broken with respect to the ultra-wealthy undermines the integrity and administrability of the entire tax system, as it applies to ordinary taxpayers and not just to the ultra-wealthy. And at the end of the day, this all flows back to realization and the ability to defer taxation of investment income. To meaningfully tax the ultra-wealthy, we must thus counteract this “original sin” of the tax system—we must end deferral.\(^7^0\)

II. **The High Costs of Favoring the Ultra-Wealthy**

In Part I we explained how a basic feature of the U.S. income tax—its reliance on realization for the taxation of investment income—facilitates tax planning strategies that use deferral to lower, and even erase, the amount of that tax. In Part III, we will explain why ending deferral requires a *current-assessment* reform, that is, one that imposes tax now, rather than a future equivalent. But first, we explain here in more detail why the problems of deferral and favoring the ultra-wealthy are not just matters of simple fairness, but rather implicate the integrity of the entire tax system. In other words, even if we agree that the income tax is broken, how broken is it?

Here we discuss ways in which the realization doctrine and deferral create harmful consequences for the income tax as whole. In explaining these consequences, we also lay the groundwork for why a current-assessment reform is required. In particular, we discuss below how the realization doctrine leads to substantially lower tax revenue, unfairness and injustice in the relative treatment of different groups of taxpayers, economic inefficiency and waste, and tax system complexity and unadministrability. In broad strokes, these are the core failings of the entire tax system, and they can each be connected back to the realization doctrine and the resulting favoring of the ultra-wealthy.

A. **Lost Tax Revenues**

We begin with the simple math. For many years, scholars have been predicting that the U.S. federal government would need “substantially higher levels of tax revenues” even just to fund ongoing government operations,\(^7^1\) and these needs have been exacerbated by the reduced revenue


and increased spending brought on by the recent economic downturn initiated by the coronavirus pandemic.\footnote{See, e.g., Andrew Van Dam, \textit{The U.S. has thrown more than $6 trillion at the coronavirus crisis. That number could grow. WASH. POST}, (April 15, 2020), https://www.washingtonpost.com/business/2020/04/15/coronavirus-economy-6-trillion/.} A number of reforms have been proposed to raise revenue—including especially a Value Added Tax, which the United States is the only major industrialized country to lack. But large amounts of tax revenue could also come just from imposing tax on the ultra-wealthy commensurate with their levels of true income and wealth.

As explained above, most of the income of the ultra-wealthy is income derived from their wealth holdings, and, as we have described, the U.S. tax system does a very poor job of taxing that income. The combination of the ability to defer reporting income from their wealth holdings plus low statutory rates on the income that is reported means very low effective tax rates on the ultra-wealthy, well below what they pay on their income for wages and salaries. If, alternatively, the ultra-wealthy’s investment income were to be taxed at the same effective tax rates as their wage and salary income, how much additional tax revenue would that raise?

As a starting point, Lily Batchelder and David Kamin estimate that a 2% wealth tax on the top 0.1% of tax households would raise $1.9–3.3 trillion over ten years, depending on the degree of tax avoidance. If expanded to the top 1%, this wealth tax could raise $3.5–6.7 trillion. For context, the Congressional Budget Office projects that the entire existing personal income tax will raise approximately $24.4 trillion over that same period, and that the entire existing corporate income tax will raise approximately $3.6 trillion.\footnote{Congressional Budget Office, \textit{The Budget and Economic Outlook: 2020 to 2030}, at 7 (January 2020).} A well-designed wealth tax could thus potentially increase revenues by more than the entire existing corporate income tax.

Key, however, is that the tax be well designed. More limited reforms would fall short. For instance, Batchelder and Kamin estimate that the combined package of eliminating stepped-up basis, taxing accrued capital gains at death, and hiking the capital gains and qualified dividends tax rate to 28% would raise only $290 billion over ten years. And they estimate that hiking the top ordinary income tax rate on income over $10 million from 37% to 70% (a near doubling of the top rate) would raise at most $320 billion over the same period.\footnote{Batchelder & Kamin, \textit{supra} note 11, at 13 (the two estimates differ because the first is by comparison to current law and the second to current policy).}

Batchelder and Kamin also estimate that a partial mark-to-market tax on publicly-traded securities, combined with a retrospective capital gains tax
on other assets, on the top 0.1% of taxpayers would raise $0.6–1 trillion over ten years, depending on the degree of tax avoidance (and $1.7–2.1 trillion if expanded to the top 1%).\textsuperscript{75} As we will discuss in Part III, we consider these reform packages to be flawed designs for mark-to-market style tax reforms, because they involve future assessment, in this case the retrospective capital gains tax component.\textsuperscript{76} Because “publicly-traded assets represent only about one-fifth of assets held by the top 1 percent,”\textsuperscript{77} relatively little tax would be currently assessed, which partially explains why their revenue estimates are less than for a full current-assessment wealth tax reform. Nevertheless, even if we view their estimates as just lower bounds on the revenue potential from a better-designed current-assessment reform, Batchelder and Kamin’s estimates still imply that the revenue potential from a well-designed current-assessment reform would be large.

\textbf{B. Real and Perceived Unfairness}

The current failure to effectively tax the ultra-wealthy also violates basic fairness norms. First, this violates “vertical equity” principles, since the effective tax rates paid by the ultra-wealthy are likely \textit{less than} the effective tax rates paid by the next richest taxpayers. Second, this violate “horizontal equity” principles since the tax rates on the types of income earned by the ultra-wealthy, namely income generated by their wealth, are less than for other types of income, namely wage and salary income, even if earned by similarly wealthy individuals. Moreover, because these tax benefits are in part a function of tax planning, the most aggressive tax planners are rewarded with lower rates, even if they have the same income as other taxpayers.

1. Vertical Equity

We take as given that vertical equity demands that income taxes on individuals and households should be progressive or, at a minimum, proportional.\textsuperscript{78} We have already shown that effective tax rates on the true economic income of the ultra-wealthy (including unreported income) are

\textsuperscript{75} Id. at 13.
\textsuperscript{76} See infra Part III.
\textsuperscript{77} Batchleder & Kamin, supra note 11, at 15.
\textsuperscript{78} See Daniel Shaviro, Selective Limitations on Tax Benefits, 56 U. Chi. L. Rev. 1189, 1222 (1989) (“Exactly what constitutes vertical equity is the subject of some dispute, with proportional and progressive tax systems being the principal competing conceptions.”).
quite low, lower than the tax rates paid by those who have a larger share of wage and salary income. But this is not the end of the analysis, since to truly judge the progressivity of the tax system, we may wish to also consider the effects of other taxes, especially the corporate and payroll taxes.

Some of the investment income that benefits from the tax strategies described in Part I is subject to business-level taxes, especially the corporate tax, and that arguably ought to be taken into account in the overall level of tax paid by the ultra-wealthy. Doing so has the potential to change the analysis. In a simplistic model, today’s statutory corporate income tax rate and personal capital gains tax rate can be added together for a combined statutory rate of about 37% on shareholder income earned through a corporation, almost equal to the top statutory rate on ordinary wage and salary income. If that were the end of the analysis, the income of the ultra-wealthy would not appear to be preferred after all.

But corporations, particularly large multinationals, have become very skilled at lowering their effective tax rates, sometime to 0%, despite often earning large accounting profits. Moreover, at least a portion of the burden of the corporate income tax is borne by other stakeholders in a corporate enterprise, especially by workers.

In addition, the effective tax rates on income invested through other types of entities and on other types of investments are often much lower. For instance, real estate investments, through the use of accelerated depreciation and debt financing, can typically achieve very low or even

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79 See infra Section I.B.

80 If a corporation earned profits of $x$, it could distribute $0.79x$ after taxes. After paying the 20% tax on dividends, and individual shareholder would have $0.632x$, i.e., have an effective tax rate of 36.8% on the corporate profits.

Alternatively, expanding this calculation to include the impact of SECA and NIIT taxes yields a top all-in rate on income earned through a corporation of 39.8%, as compared to a top all-in rate of 40.8% on wage and salary income. See Batchelder & Kamin, supra note 11, at 5–6, for the details behind these calculations.

81 According to the CBO, the effective corporate tax rate in the U.S. in 2012 was 18.6%, at a time when the statutory rate for larger corporates was 35%—implying that the average corporation can cut the statutory rate nearly in half through planning. Congressional Budget Office, International Comparisons of Corporate Income Tax Rates, at 17 (March 2017), https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/reports/52419-internationaltaxratecomp.pdf.

82 Estimates vary, but a typical assumption is that about a quarter of the corporate tax is borne by labor, creditors, customers, and others. For instance, the Joint Committee on Taxation and the Congressional Budget Office assume in their models that 25% of the corporate tax burden is on labor. See Joint Committee on Taxation, Modeling the Distribution of Corporate Income Tax Revenues, JCX-14-13 (2013); Congressional Budget Office, The Distribution of Household Income and Federal Taxes, 2008 and 2009 (2012).
negative effective tax rates. Much pass-through income is now entitled to the new 20% deduction for qualified business income. And, as discussed, by deferring realization of income at the individual level, taxpayers can compound these benefits before finally realizing taxable income.

Furthermore, if we are to take account of the corporate income tax, which most analysts consider to be at least somewhat progressive, then arguably we also should include payroll taxes and state and local taxes, which most analysts think are more regressive. Recent research by Emmanuel Saez and Gabriel Zucman examines a broad set of tax burdens and concludes that the all-in effective tax rate on the richest 400 households may actually be lower than the tax rate paid by the bottom half of the income distribution, even without fully accounting for unrealized capital gains. Their finding is disputed, but even if the overall tax system turns out to be modestly progressive with respect to reported income, we still need to consider the dramatic benefits from unrealized gains, especially from the sort of dynastic wealth that can take advantage of the step-up in basis and "buy, borrow, die." In all likelihood, that pushes the tax system back into regressive territory.

2. Horizontal Equity

The vertical equity analysis is not free from doubt. It is difficult to

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84 See I.R.C. § 199A.
86 There are real questions about whether and to what extent any of these other forms of taxation should be taken into account—including for the corporate income tax, which arguably mostly just reaches excess returns at the corporate level. However, a thorough discussion of these questions is beyond the scope of this Article.
conclusively determine whether the tax system as a whole is progressive, proportional, or regressive—especially with respect to the ultra-wealthy. This is because of uncertainty about the distributional incidence of business-level taxes, because there is no clear dividing line between what should be considered part of the tax system as opposed to a part of other governmental programs, because of the difficulty of estimating the long-term magnitude of unrealized capital gains with any precision, and because of other murky methodological issues. Regardless, even if we assume, for the sake of argument, that the tax system as a whole is progressive with respect to the ultra-wealthy because of the corporate income tax, this does not imply the absence of substantial fairness violations, because the treatment of capital income still raises issues of horizontal equity, i.e., the requirement that like taxpayers be treated alike.

Effective tax rates on different forms of investment income differ wildly, with corporate equity investments potentially being taxed at relatively high effective rates (at least absent tax gaming) but with many other forms of investment income being taxed at much lower or even negative effective rates. Batchelder and Kamin show that the present value of the top possible marginal tax rates vary for a select set of common investment strategies from a high of 40.8% to a low of 0%. Similarly, the Tax Foundation, a conservative think tank, estimated that—prior to the 2017 tax overhaul—the effective tax rates on investment income varied from as high as 38% (for some corporate equity) to as low as negative 6% (for some corporate debt), depending on how the investments were structured.

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90 See Joint Comm. on Tax’n, Modeling the Distribution of Taxes on Business Income, (JCX-14-13) (Oct. 16, 2013.).
91 See, e.g., Edward D. Kleinbard, We Are Better Than This: How Government Should Spend Our Money (2016) (urging scholars and others to consider complete fiscal systems, not tax systems alone); Brooks, supra note 24, at 270–74 (on the mutability of the income concept, especially when considering government benefits).
92 See Sullivan, supra note 87.
93 See, e.g., McCaffery, Taxing Wealth Seriously, supra note 13, at 329–30 (discussing the sparse data on unrealized capital gains).
95 See supra notes 81–84 and accompanying text.
96 Batchelder & Kamin, supra note 11, at 5–7.
97 Alan Cole, Interest Deductibility – Issues and Reforms, Tax Foundation Fiscal Fact No. 548, at 4 (May 2017) (“Debt-financed corporate capital has an effective rate of negative 6 percent, 44 percentage points lower than the rate on equity-financed corporate capital”). These estimates were made prior to the 2017 tax overhaul, which reduced the statutory corporate income tax rate and thereby reduced the effective tax rate on corporate
In addition to the efficiency and economic-distortion harms that we will elaborate below, this wide variance in effective tax rates on different forms of investment income results in a prima facie violation of horizontal equity. That is, even if we grant for the sake of argument that the corporate income tax makes the tax system as a whole progressive with respect to the ultra-wealthy as a group, the widely different effective tax rates on different forms of investment income creates wide disparities in the effective tax rates facing individual members of the ultra-wealthy, with at least a substantial number of ultra-wealthy taxpayers thus almost certainly facing very low effective-average tax rates from all sources combined. Moreover, as Batchelder and Kamin explain, “[i]t also means that, among the wealthy, the most aggressive tax planners are rewarded, while those who follow the letter and spirit of the law are penalized. Heirs to large fortunes are taxed especially lightly.”

3. The Consequences of Perceived and Real Unfairness

The prior two subsections detailed the unfairness of providing tax preferences for the type of income earned by the ultra-wealthy—namely investment income—and also of the wide disparity in the tax treatment of different forms of investment income. We believe that this case is solid, almost inarguably so. But some may still push back, perhaps even by questioning the utility of thinking of “fairness” as a valid norm for policymaking. We address below other critiques more rooted in economic and administrative consequences. But, first, it is important to note that the public’s perception of unfairness may be as or even more important than a rigorous demonstration of unfairness itself, and also that the existence of unfairness can have serious negative social and political repercussions.

If the public believes that the income tax system is biased against ordinary people and in favor of the ultra-wealthy, this may have very real consequences. And, indeed, there is reason to infer that the public’s awareness of how the income tax fails with respect to the ultra-wealthy actually undermines perceptions of fairness, harming both the public’s faith in the overall tax system and associated tax morale and compliance, and

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98 Batchelder & Kamin, supra note 11, at 8.
100 See, e.g., Erzo F. P. Luttmer, and Monica Singhal, Tax Morale, 28 J. ECON. PERSP. 149 (2014).
possibly also affecting views of the overall fairness of our economic and political system.\footnote{See, e.g., ERICH KIRCHLER, THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOUR 78–84 (2007).} For example, as Benjamin Friedman, among others, has argued, cultural breakdown and the rise of populism and reaction can often be connected to periods where masses of people felt that they did not share in a society’s prosperity, when they feared that their children would be worse off than themselves.\footnote{See BENJAMIN M. FRIEDMAN, THE MORAL CONSEQUENCES OF ECONOMIC GROWTH (2006).}

Moreover, even if one is still skeptical of the moral case for taxing the ultra-wealthy more, there are secondary consequences of a system that allows the ultra-wealthy to continue to accumulate wealth rapidly. For example, having extreme concentrations of wealth affects how and what kind of financial, economic, and investment decisions get made, and also affects politics and political influence. There is little doubt at this point that money has an enormous influence in politics, and when that money is concentrated in the hands of relatively few people, it can have negative effects on democracy, even to the degree of threatening our country’s democratic legitimacy.\footnote{On the relationship between extreme wealth and efforts to undermine democracy, see, e.g., NANCY MACLEAN, DEMOCRACY IN CHAINS: THE DEEP HISTORY OF THE RADICAL RIGHT’S STEALTH PLAN FOR AMERICA (2018); JANE MAYER, DARK MONEY: THE HIDDEN HISTORY OF THE BILLIONAIRES BEHIND THE RISE OF THE RADICAL RIGHT (2017). This relationship is not a new phenomenon. See, e.g., NANCY COHEN, THE RECONSTRUCTION OF AMERICAN LIBERALISM, 1865–1914 (2002).}

Finally, the income tax is directly implicated in racial injustice. As Strand and Mirkay—among many others\footnote{E.g., Jeremy Bearer-Friend, Should the IRS Know Your Race? The Challenge of Colorblind Tax Data, 73 TAX LAW REVIEW 1, 39–41 (2019) (listing studies finding that tax policies have disparate racial outcomes); Dorothy A. Brown, Shades of the American Dream, 87 WASH. U. L. REV. 329 (2009).}—have explained, the federal income tax operates “directly to increase wealth inequality, deepening pre-existing historically-based racial wealth disparities.”\footnote{Palma Joy Strand & Nicholas A. Mirkay, Racialized Tax Inequity: Wealth, Racism, And The U.S. System of Taxation, 15 NW. J. L. & SOC. POL’Y. 265, 266 (2020).} Specifically, by heavily taxing wage and salary incomes, and only lightly taxing the returns to owning wealth, the tax system obstructs historically disadvantaged groups from building wealth and economic power while protecting the comparative economic power of historically advantaged groups that started accumulating wealth during more illiberal periods.\footnote{Id. at 279.} This is another concrete harmful consequence of the unfairness engendered by the existing
income tax.

C. Economic Inefficiency and Waste

Above, we noted the wide disparities in the effective tax rates facing different types of income and investment strategies, and we argued that this results in both revenue loss and prima facie fairness violations. We will now explain how this also causes inefficiencies and economic waste. In particular, we address the welfare costs associated with the choice to raise a relatively greater share of revenue from wage and salary income versus investment income, and the welfare costs of allowing taxpayers to use tax gaming strategies to opt in to lower effective tax rates. These two points are related to the issues raised in subsections A and B, respectively, but are nonetheless distinct analytically.

First, note that if an additional dollar of tax revenue is needed, it is most efficient (from a welfare-economics perspective) to raise it from the source with the lowest marginal utility of wealth.\(^\text{107}\) That is, if the government wants $1000 more in tax revenue, it will have lower social cost to raise it from Bill Gates rather than from Bill Gates’s gardener. Taxing Gates an additional $1000 will have almost zero utility cost to Gates, but could meaningfully affect the utility, or well-being, of the gardener.\(^\text{108}\)

Extending this point, the policy choice to lightly tax investment and capital income implies a choice to more heavily tax labor income, like wages and salaries. As we have already explained, investment income is highly concentrated in the ultra-wealthy, and so taxing labor income more than investment income means, on average, taxing those with higher marginal utility of wealth rather than those with lower marginal utility, thus generating unnecessary economic inefficiency and loss of social welfare.\(^\text{109}\)

\(^{109}\) One can argue with the assumption of zero marginal utility of wealth for the ultra-wealthy, in part because it may contradict the observed degree of effort many ultra-wealthy put into increasing their wealth yet more. A full accounting of the psychology of the ultra-wealthy is beyond the scope of this Article, but we can note a few things. First, there are number of other utility benefits that flow from work, especially in prestigious positions or professions. Second, those who work hard primarily just to increase their wealth may see it more of as a “scorecard” in the game of life, so that ordinal ranking is more important than cardinal amounts. See generally, e.g., Robert H. Frank, *Luxury Fever: Weighing the Cost of Excess* (2010). Third, to the extent some ultra-wealthy go out of their way to avoid taxes, it could also be that this group is particularly opposed to taxation qua taxation and so an appropriation of wealth through the tax system might cause excessive utility loss.
Second, recall the range of effective tax rates on different types of income. The current top all-in effective federal tax rate is 40.8% for wage and salary income reported on a W-2, and is 39.8% for income that is first fully subject to the corporate income tax and is then also fully taxed at the personal level at the top capital gains rate (plus the NIIT surtax rate).\footnote{110} The current top all-in effective federal tax rate is 23.8% for pass-through or other non-corporate investment income that is characterized as long-term capital gains, and 20% if this income takes advantage of loopholes to avoid the NIIT and SECA surtaxes.\footnote{111}

But these effective rates can become 0% if realization is deferred until after death (taking advantage of stepped-up basis) or if other strategies are used to eliminate the deferred tax on unrealized gains (such as if profits are shifted to tax havens in a manner that avoids GILTI).\footnote{112} And commonly used tax-gaming techniques can reduce these top effective tax rates further, often yielding negative effective tax rates.\footnote{113} Thus, standard tax planning strategies can yield tax savings of between twenty and forty cents on the pre-tax dollar, and maybe more.

In light of this, what stops wealthy taxpayers from using strategies like “buy-borrow-die” even more than they currently do, so as to wipe out all personal-level tax on investment income (rather than stopping after just eliminating most of this tax)? Why do the ultra-wealthy pay any tax at all?

The catch is that these tax gaming strategies come at a cost, and these costs generally increase as the strategies get more complicated and aggressive to cover more economic income.\footnote{114} Examples of these costs of tax planning include lower liquidity,\footnote{115} the costs of borrowing,\footnote{116} relatively to other kinds of wealth declines. See, e.g., KLEINBARD, supra note 91. Ultimately, these are empirical questions that might be interesting to answer, but which are not a first-order concern—that is, a benevolent social planner ought not to care too much about a utility loss from this small group of ultra-wealthy taxpayers, particularly if the planner “welfare weights” transfers to the least well-off, as most analysts assume. See, e.g., Emmanuel Saez & Stefanie Stancheva, Generalized Marginal Welfare Weights for Optimal Tax Theory, 106 AM. ECON. REV. 24, 41 tbl. 2 (“social welfare weight” of nearly zero for highest income group); Diamond & Saez, supra note Error! Bookmark not defined., at 168–69.\footnote{110}

\footnote{110} Batchelder & Kamin, supra note 11, at 5–7.
\footnote{111} Id.
\footnote{112} Id.
\footnote{113} Id.; Chason, supra note 59, at 545.
\footnote{114} Gamage, supra note 65, at 375–82.
\footnote{115} Because, e.g., it means not realizing gains and instead keeping profits invested in illiquid assets.
\footnote{116} Because, e.g., Larry Ellison–style credit lines charge interest.
transaction costs of tax-loss harvesting,\footnote{117 See C. Eugene Steuerle, Taxes, Loans, and Inflation: How the Nation’s Wealth Becomes Misallocated 18–24 (Brookings Institution 1985).} deviating from taxpayers’ risk-reduction and diversification preferences,\footnote{118 Id.} the excessive complexity of more sophisticated forms of tax gaming, and the cost to businesses from using inefficient capital structures in order to generate tax savings.\footnote{119 Id.}

As C. Eugene Steuerle explained in his seminal book on the topic, “insofar as capital income is concerned, the individual income tax is primarily a discretionary tax.”\footnote{120 Id.} As a result, at least with respect to the investment income of the wealthy, the income tax is effectively just a tax on the limitations to tax gaming that deter wealthy taxpayers from gaming away all of their tax liabilities, so that “the discretionary income tax on capital income is a tax on liquidity, risk reduction, and diversification rather than a tax on income.”\footnote{121 Id.}

The key takeaway here is that tax gaming typically involves real economic costs, and, at the margin, these costs should generally approach the effective marginal tax rates.\footnote{122 Gamage, supra note 65, at 375–82.} While incurring these costs may be rational for individual taxpayers, it is exceedingly wasteful to an economy as a whole.\footnote{123 Id; Glogower, supra note 22, at 122–23.} In other words, the productive potential of the overall economy is diminished because scarce resources are devoted to tax gaming at the expense of productive investment and business activity.

\section*{D. Complexity and Uncertainty in the Tax System}

Perhaps even more troublesome than the other sorts of harmful consequences explained above, the manner in which the personal income tax is broken and readily exploited by the ultra-wealthy’s tax gaming undermines the administrability and integrity of the entire tax system. Fully
explaining how and why this is so is beyond the scope of this article. But the key point is that the realization doctrine, along with the corresponding capital gains preference, generate the lion’s share of legal complexity and uncertainty in the income tax, ultimately undermining the tax system itself.

As noted above, because the realization doctrine makes deferring capital gain trivial, it is generally believed that a preferential rate on capital gain income is needed to reduce that disincentive to realize gains. This then creates a need to distinguish capital gains and capital losses from ordinary income and ordinary losses, and that task is a major source of uncertainty and confusion in the tax law. For instance, with respect to the important category of real estate transactions, a federal judge famously proclaimed it to be a “truism” that “[i]f a client asks you in any but an extreme case whether, in your opinion, his sale will result in capital gain, your answer should probably be, ‘I don’t know, and no one else in town can tell you.’”

The muddled state of the law on distinguishing ordinary and capital income motivates wasteful tax planning, and, beyond that, creates large compliance burdens and traps for the unwary, including for small businesses and other more ordinary taxpayers (as opposed to just the ultra-wealthy). As Reuven Avi-Yonah and Dmitry Zelik have explained, “a lot of the complexity of the current tax code results from attempts to block taxpayers from converting ordinary income to capital gains … and from the limitations on offsetting ordinary losses against capital gains, which has resulted in transactions designed to create artificial capital losses …” Indeed, these harmful consequences are so severe that Avi-Yonah and Zelik argue that, if it is not possible to adopt a current-assessment reform to replace realization, then we should abandon the goal of increasing progressivity at the top and instead make the top tax rate 28% for both ordinary income and capital gains. This is because, they argue, 28% is the maximum rate that can be imposed on capital gains in a realization-based

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124 For related discussion, see Glogower, *supra* note 22, at 123–24.
125 See *supra* notes 68–70 and accompanying text.
127 *Byram v. U.S.*, 705 F.2d 1418, 1419 (5th Cir. 1983). See also Tony Nitti, *Tax Geek Tuesday: Does The Sale Of Property Generate Ordinary Income Or Capital Gain?*, FORBES, December 31, 2013 (“Some questions simply can’t be answered. For example … Will the sale of my property give rise to capital gain or ordinary income?”).
130 It should be noted that the top marginal tax rate on ordinary income was the same as the top capital gains rate from 1988 to 1990, following the Tax Reform Act of 1986. Pub. L. No. 99-514 §§ 101, 302, 100 Stat. 2085, 2096, 2218.
system and because the harms that result from the capital gains preference are so damaging as to make it not worth taxing ordinary income at a higher rate. In their framing, our only choices in a realization-based system are to either retain the preferential capital gains rate or slash the top rates on ordinary income. Despite their preference for “higher rates on the rich,” they “have reluctantly come to the conclusion that we are indeed trapped by our capital gains, that the current rate structure is indefensible in practice, and that we should revert to an overall rate of 28% for all income.”\textsuperscript{131}

For a related example, consider the difficulties of distinguishing between when payments from businesses to investors should be considered returns to investment as opposed to wages or other disguised payments for labor or services.\textsuperscript{132} Under current law, the personal capital gains preference and the various surtaxes like SECA and NIIT mean that the way payments from businesses to investors are characterized can yield quite different personal-level tax consequences.\textsuperscript{133} This results in widespread tax gaming and major inefficiencies and inequities.\textsuperscript{134}

It is not an exaggeration therefore to say that the realization doctrine, along with the corresponding capital gains preference, significantly harms the integrity and functioning of the overall income tax system. In addition to opening the door to tax preferences that benefit the ultra-wealthy, the realization doctrine leads to excessive and unnecessary legal complexity and uncertainty affecting many more ordinary taxpayers. In the next Part, we explain why current-assessment reform is required to effectively tax the ultra-wealthy, but it is an additional benefit that many current-assessment reforms would minimize or remove the need for a capital gain preference.

III. THE NEED FOR CURRENT-ASSESSMENT TAX REFORM

The previous two Parts explained how the realization doctrine and the availability of deferral have fundamentally broken our income tax, particularly with respect to its treatment of the ultra-wealthy, as well as explaining some of the harmful consequences of that failure. The clear solution is to end deferral. But how?

With certain notable exceptions,\textsuperscript{135} the prior literature has mostly
embraced reforms that would seek to limit or end the financial benefits of deferral while still fully or partially retaining the realization doctrine—i.e., these reforms would not assess tax until a gain is realized through a sale or exchange, at least for some important categories of assets. For example, such a reform might postpone the assessment of tax on illiquid assets, such as shares in privately held firms, until those shares are sold, but would impose at that time an interest charge to offset the benefits of deferring the assessment until that time.\footnote{For instance, the Ranking Democrat on the Senate Finance Committee, Ron Wyden, recently proposed a reform of this sort (Sen. Ron Wyden, \textit{Treat Wealth Like Wages}, available at \url{https://www.finance.senate.gov/imo/media/doc/Treat\%20Wealth\%20Like\%20Wages\%20RM\%20Wyden.pdf}). We explain why this sort of future-assessment reform is likely to fail in Part III.B.1. \textit{infra}.}

We argue here, however, that such future-assessment reforms are insufficient. To truly repair the personal tax system and meaningfully tax the ultra-wealthy on their economic income (or on any alternative comprehensive measure of wellbeing or ability to pay) a current-assessment reform is needed. That is, we need a reform that would assess and impose tax on a periodic basis as economic income accrues (or, alternatively, as wealth or spending power accumulates), rather than attempting to tax at some future date that may never actually occur.

Section A below lays out our theory for the necessity of a current-assessment reform. The key insight is that, although a future-assessment reform might theoretically cancel out the financial benefits of deferral under existing law, it is powerless against the effects of future political shifts. As a simple example of this point, consider that if a future-assessment reform is put in place, but a later political coalition repeals it before any gains are actually realized, it will have accomplished nothing.

To clarify the difference between current-assessment and future-assessment reforms, and why current assessment is superior, Section B discusses two leading future-assessment reforms, retrospective capital gains taxation and progressive consumption taxation.

Section C then explores several prior real-world examples of the difficulties posed by political shifts. This review illustrates the centrality of political optionality to tax politics. Time and again, taxpayers have managed to undermine future-assessed taxes, and there is every reason to expect that this will generally be the fate of future-assessment tax reforms.

\textbf{A. Current Assessment: Tax Now or Tax Never}

We argue that meaningfully taxing the ultra-wealthy, and thereby
beginning to repair our tax system, requires reform that is sufficiently robust against the possibility of future legal change. In particular, any reform must not rely on tomorrow’s Congress or executive agencies to ensure meaningful taxation of today’s income or wealth accumulations. In other words, what is needed is a current-assessment reform—we must tax now, not later.

To sketch out our approach, consider the following thought experiment. Suppose that a political coalition enacts a reform with the goal of successfully taxing the ultra-wealthy. Further suppose that this reform will take effect across two time periods. In the first period, some economic income is earned, perhaps by appreciation in the value of an asset. In the second period, a tax is imposed on that first-period income which is the present-value equivalent of the first-period tax (had it been imposed). What happens by the time we reach the second period?

There are essentially three possibilities. First is that the original reform coalition both remains in power and remains fully committed to bolstering the reform. As a result, this coalition is able to fend off political attacks against the reform while passing any necessary follow-up legislation or taking other necessary follow-up actions to reinforce the reform, as policymakers start to observe both the efficacy of the reform itself as well as taxpayer responses to it, many of which will likely have been unanticipated at the time of the initial enactment.

A second possibility is that there is a complete shift to an opposing political coalition, and the new coalition then either fully repeals the reform or replaces it with a new regime that is more favorable to its supporters.

The third possibility is that we could end up somewhere in the middle, with the original reform coalition either weakened or less committed to bolstering its initial reform, but with that original coalition retaining enough power and commitment to block its reform from being completely repealed or replaced. In this case, full repeal of the original reform is unlikely, but so is the incremental maintenance and adjustment that is required to make the original reform operate effectively.

Our observation from past reforms, both tax and non-tax, is that the probability of the second and third possibilities together greatly outweighs the first. Indeed, we believe that the most likely outcome by far is the third possibility—a gradual erosion of the reform due to neglect because the original coalition is too weak to bring necessary incremental reforms in the face of taxpayer innovation, changing economic circumstances, and experience with the actual effects of the law.

\[137\] See infra Section III.C.
If this is the case, then there is a significant likelihood that any tax actually imposed in the second period will not in fact be the present-value equivalent of tax in the first period, even if that was the way the law was written, and this becomes increasingly likely the longer the length of time between the first and second periods. Of course, this outcome would obviously follow from a full repeal of the initial reform. But more likely is that the initial reform would just be eroded somehow—by taxpayers devising strategies in the interim period to game around the law; by economic conditions changing so that the assumptions underlying the initial reform no longer hold and in a manner that erodes the initial reform; by relatively minor changes to the initial law, well short of full repeal, that nevertheless undermine its intended effects, such as rate changes or new exemptions; by critical errors in the original law going uncorrected; and so on. While some tax may still be collected in the second period, the effective tax rates may be so reduced as to make deferral still very rewarding.

Exacerbating all of this, sophisticated taxpayers can often anticipate and even influence the likelihood of these (favorable to them) outcomes. There is an option value to waiting, and for the ultra-wealthy, even minor erosions in the law could generate a huge return to deferral. The clear conclusion therefore is that reforms that rely on the imposition of tax in the second period are inferior to those that impose tax in the first period—current assessment. Choosing to tax later risks taxing never.

To fill out and formalize the theory, we need to introduce a few terms and concepts. We have already distinguished a current-assessment reform from a future-assessment reform. For purposes of our argument, we assume that either reform as drafted would impose the same present-value equivalent tax (in financial terms). The key difference is the timing of that assessment—tax now or tax later.

In considering the benefits of deferral—of waiting—the prior literature mostly just considers what we label as the existing-law benefits of deferral, that is, the benefits that are encoded into existing law. These existing-law benefits of deferral can be further broken down into time-value benefits (that is, the financial benefits of deferring tax liabilities due to the time-value of money) and loophole benefits (that is, the ways under current law that taxpayers can reduce or completely wipe-out deferred tax liabilities, such as the Section 1014’s step up in basis on death). Most leading reform proposals aim to eliminate one or both of those benefits.138

138 With respect to loophole benefits, this has mostly consisted of calling for the end of existing loopholes like Section 1014. With respect to time-value benefits, the prior literature has proposed reforms that would eliminate time-value benefits by taxing deferred liabilities upon realization, such as by imposing an interest charge to offset the time-value
But there is another benefit of deferral: the ability to wait for favorable legal or political change. We label this the political optionality benefit of deferral. If there is some chance that a reform could erode or be repealed in the future—and, with future-assessment reforms, there always is—then there will still be incentives to defer realization of gain, even if the tax on that gain would be the present-value equivalent of a current tax, were it to be assessed. In other words, if there is some non-zero probability of a taxpayer-favorable future legal change, then this lowers the expected value of that future tax below the present-value equivalent. Put yet another way, options have real value, as any financial professional would tell you, and the possibility of future legal change gives the ultra-wealthy that option for free. Both historical experience and political theory strongly imply that the ultra-wealthy are likely to take advantage of options to defer their tax liabilities so as to then wait for more favorable political or legal changes.

To be sure, current-assessment reforms are also at risk of future erosion or repeal, and there is no guarantee that future political change will be favorable to the ultra-wealthy. But institutional, political, and economic realities put a heavy thumb on the scale in favor of the ultra-wealthy, when it comes to future-assessment reforms, thus giving political optionality a positive value. Of course, it is theoretically possible that a current-assessment reform could be reversed in the future, along with taxpayers then being given refunds for any tax previously paid. However, as we will explain, this is dramatically less likely to occur as compared to a future-assessment reform being eroded or terminated prior to the assessment of tax. We will now proceed to elaborate three sets of pressures that all add up to creating large political optionality benefits with respect to future-assessment reforms.

1. Policy Drift and the Need for Incremental Bolstering

The standard view of the U.S. federal legislative process is that it features a heavy status quo bias—that is, major policy reform of any kind is extremely difficult. The typical explanation for this is that the U.S. benefits. See supra note 18.

Or almost free—other costs, like costs of borrowing or of non-diversification are real, but relatively minor (inframarginally) relative to the tax benefits. See Steuerle, supra note 13.

system features a high number of “veto” or “pivot” points. That is, in order for legislation to be enacted, it has to get past a number of hurdles. For example, at various points in the legislative process, the House Speaker, the median House Member, the Senate Majority Leader, the 60th Senator, the President, and the 34th Senator and 146th House Member (for overcoming a Presidential veto) all could have the power to stop a piece of legislation. Because these individuals may occupy very different points on the ideological spectrum, it is exceedingly hard to design a major reform that can overcome all the pivots.

Moreover, a reform that can get over all of these veto points is likely to be somewhat unstable. As Jason Oh has argued, if a large reform package is a product of negotiation and compromise, it may contain individual policies that would not have had sufficient support to pass on their own—that are only passed because of political horse-trading. However, if those policies can be legislatively decoupled after passage, then one or more of them is at risk of repeal or change, even if the other parts of the reform stay in place.

This helps to explain why the U.S. typically experiences policy drift—that is, why legislated policies tend to evolve somewhat organically over time, often without clear action by legislators. This sort of policy drift can take a number of forms, which are worth isolating for clarity.

First, there is the sort of incremental repeal that Oh explains—whereby legislators might find sufficient support to make small changes that serve to partially undermine a larger reform package.

For a concrete example, consider the “Cadillac” tax passed as part of the Affordable Care Act—an excise tax on expensive health care plans. The tax was included for two reasons. One, to try to offset the tax benefit of the exclusion for employer-provided health care by clawing back the tax benefit of the exclusion for the highest earners. Two, the tax was a revenue-raiser to ensure that the ACA got a favorable budget score from the Congressional Budget Office. For both these reasons, it was meant to be an important part of the original compromise of the ACA. Yet, the Cadillac tax was repealed before it ever took effect. Once it could be peeled off from the full ACA, it became unpopular and unstable, and thus subject to incremental erosion and then repeal. Compared to the original design of the ACA, that repeal had the effect of shifting the costs of the ACA away from
Second, a legislated policy might remain static, but with the underlying economic or other conditions changing in a manner that impacts the policy’s effectiveness. This second dynamic is especially likely to occur in the context of distributional policies, tax or otherwise, and to gradually undermine the distributional impact of such policies. As we discuss below, this is a key aspect of the story of stepped-up basis—a policy that had some logic in 1921, but then remained in place even as other policy changes and developments later destroyed that logic.

Third, and perhaps most importantly, policy drift can occur in the form of bureaucratic drift—that is, where the legislation itself remains static, but with regulators and others in federal agencies affecting the resulting policy in other ways. In most cases, regulators’ ability to move policy is real but limited. Major reform is unlikely to come from only an executive agency, but smaller changes are possible and are often unlikely to be checked by Congress. This is because stopping this sort of bureaucratic drift may require Congress to pass new legislation (unlikely, for all the reasons discussed above), individuals to engage in successful litigation (which is risky, expensive, and delayed), or voters to change the party controlling the presidency.

On its own, this story of status quo bias and policy drift does not indicate which way a policy will drift. If drift were random, it might be just as likely for the original reform to become stronger, rather than weaker. Alas, history and theory suggest otherwise, particular in the case of policies—tax and non-tax—that focus on issues related to inequality and distribution. The nature of distributional policies is that they typically have concentrated harms (on the wealthiest) but diffuse benefits (on the rest of the population)—a dynamic that is well known to produce lopsided outcomes.

We should thus expect that both acts and failures to act will

the relatively well-off taxpayers who tend to have these sorts of high-value health plans.


147 Hacker & Pierson, supra note 140, at 52–54; Gilens, supra note 141, at 79–80 (showing asymmetry of government responsiveness to policy preferences of rich and poor); E.E. Schattschneider, The Semisovereign People: A Realist’s View of Democracy in America 32 (“[T]he [political] pressure system has an upper-class bias.”) (1960).

148 See, e.g., Mancur Olson, The Logic of Collection Action: Public Goods
generally be more likely to benefit the already well-off at the expense of the less well-off.

Moreover, policy drift in favor of the wealthiest is especially likely the more that important aspects of the policies in question are too complicated to be well understood by the general voting public or communicated to the voting public via mass media. The history of U.S. tax administration is rife with examples of important, but complicated details of the tax system drifting in a manner that favors the wealthiest. Some of these examples include Congress legislating such changes, but many are based on regulators at Treasury or IRS revising interpretations of the tax code to favor the wealthiest, or the failure to block new forms of tax gaming that undermined the effect of the rules to the benefit of the wealthiest.

Because the costs of tax policies aimed at the wealthiest are concentrated, and the benefits diffused, there is a heightened hurdle to achieving any reforms that would meaningfully tax the wealthiest. But this hurdle can be overcome to the extent that the reforms in question are sufficiently popular with the overall voting public. Yet for this popularity to


149 See Hacker, supra note 145, at 252 (on “incremental” and “subterranean” policy drift in favor of the wealthy).


152 Daniel J. Hemel, The President’s Power to Tax, 102 CORNELL L. REV. 633 (2017) (explaining that and why the Treasury Department only minimally uses its powers to support revenue raising and instead generally acts in a revenue-losing manner); Brian Galle & Stephen Shay, Admin Law and the Crisis of Tax Administration (explaining why tax agencies are biased “against revenue and against the poor”) (incomplete draft of July 3, 2020, on file with authors and cited with permission).
matter, the voting public must understand the policies in question at least well enough to reward politicians and other political actors supporting such policies and to penalize politicians and other political actors opposing them. Consequently, the more complicated and difficult to understand are the policies in question, the less likely it is that public opinion can effectively counteract the concentrated political power wielded by the wealthiest who would suffer the costs of distributional tax policies.\footnote{It is important that current-assessment reforms, such as a wealth tax, are easier to explain to voters than future-assessment reforms, like retrospective capital gains taxation or repealing the step-up in basis, though that fact is not a function of political optionality.}

The dynamics of tax deferral are inherently complicated and difficult to convey to the voting public, as are the mechanics and effects of provisions like Section 1014’s step up in basis that can serve to negate tax following deferral. By contrast, the voting public typically finds it much easier to understand tax policies that raise revenue currently, and tax cuts offered with respect to such policies are typically more salient.\footnote{This is partially an artifact of budget rules, as explained further in subsection III.A.3 \textit{infra}. But this is also an artifact of the fact that definitions of income and of other tax-base measurements are inherently murky with respect to time, which makes it impossible to convey unambiguous and uncontroversial revenue or distributional information with respect to unrealized gains and other future-assessment components of tax systems. \textit{See} Sullivan, \textit{supra} note 88; Brooks, \textit{supra} note 24. By contrast, it is relatively easy to measure the tax revenues actually paid (or expected to be paid) in any given year, which makes it relatively easy to communicate related information about these measurements to the voting public. For a more extended discussion of factors affecting tax salience, \textit{see} David Gamage & Darien Shanske, \textit{Three Essays On Tax Salience: Market Salience and Political Salience}, 65 TAX L. REV. 19 (2011).}

Overall, this picture of U.S. policymaking suggests that major reform is difficult and rare, and that when it happens, it will be at least partially undermined over time by policy drift, unless the original political coalition remains at its full strength and also retains its full initial commitment to the reform—which almost never happens. In the more likely scenario, party and ideological control will shift over time, opening the door to a gradual erosion of the original policy. And this is especially likely the more complicated and difficult it is to convey the essence of the reform to the general voting public.

Consequently, for a major tax reform targeted at the ultra-wealthy to remain effective over time, it is crucial to implement as many key mechanics of the reform as possible at the time of enactment, or soon thereafter, while the original reform coalition still retains its strength and commitment. Future-assessment tax reforms do the opposite. This is because putting off the actual assessment and collection of tax means also putting off the review of the tax gaming techniques that taxpayers will
devise in their attempts to escape the tax, putting off the technical revisions
and other administrative responses that will need to be made to correct the
unanticipated difficulties that will inevitably arise as part of assessing and
collecting tax, and, more generally, putting off the many administrative
gency decisions required to effectuate tax assessment and collection.

Effectuating a major tax reform requires more than just passing the
initial legislation. Many crucial administrative decisions and technical
corrections must be made at the time that taxes are actually assessed and
collected. For current-assessment tax reforms, this typically happens during
or immediately following the reform being enacted, while the initial reform
colition typically maintains its full strength and commitment and while key
administrative officials and staff are thus typically oriented toward
bolstering the reform. By contrast, for future-assessment tax reforms, much
of this typically happens later, potentially many years or even many decades
later, by when the initial reform coalition will likely have lost at least some
of its strength and commitment to the reform, and by when key
administrative officials and staff are typically motivated more by the
asymmetric pressures that tend to undermine distributive policies over time
and motivated less by any remaining commitment to bolstering the tax
reform.

These dynamics make it dramatically more likely that a future-
assessment reform will be eroded or undermined prior to the assessment of
tax, especially as compared to the likelihood of a current-assessment reform
being fully repealed with taxpayers then being given refunds for tax
previously paid through a current-assessment reform. Whereas taxing now
is relatively certain, taxing later is quite tentative.

2. The Time Value of Options

Embracing the political optionality metaphor literally, the longer the
time to maturity of an option, the greater its value.\footnote{155} For a financial option,
the logic is that the longer the time until the option expires, the greater the
likelihood that the option will end up “in the money,” i.e., with strike price
greater than the spot price for put option, or vice versa for a call option.\footnote{156}

Political optionality has the character of a put option. The taxpayer has
an asset with built-in gain, and she could realize that gain today or
tomorrow. If, because of a change in the tax regime, tomorrow’s after-tax
price could be higher than today’s (all else equal), then a rational taxpayer

\footnote{155} See, e.g., \textsc{David S. Kidwell et. al.}, \textsc{Financial Institutions, Markets, and Money} 323 (2017).
\footnote{156} \textit{Id.}
could wait to see—and might even pay for the option of waiting.

In the context of tax reform, a future-assessment tax, assessed at the present-value equivalent of a currently assessed tax, carries with it an option to wait for a more favorable regime. And, as with financial options, the longer the time until that future assessment, the greater the likelihood of a taxpayer-favorable change—for example, by waiting for a Congressional or Presidential election that shifts power in a taxpayer-favorable direction. If that new Congress or new Presidential appointees to key administrative agencies act to minimize or repeal that future-assessed tax, the taxpayer can then “exercise” the option to realize the gain under that new law.

To be clear, the path of legal change does not need to be monotonically in favor of the taxpayer for this to work. It could be that one Congress passes a future-assessment reform, and the next Congress makes it even stronger. But if the Congress after that weakens or repeals the reform, the option is still valuable. Just as an asset price might be volatile, so can tax policy. Indeed the value of a financial option tends to increase with volatility in the price of the underlying asset. All the taxpayer needs to do is wait for a favorable moment to realize a gain—and, as we discuss, history shows that taxpayers tend to do exactly that.

Indeed, the option value that results from future-assessment tax reforms is even easier to exercise than are financial options, because taxpayers are typically given advance notice of upcoming political and legal changes as such changes work their way through the legislative or administrative process. Whereas the prices in financial markets are typically forward looking, taxpayers can often act to recognize their deferred tax liabilities in advance of upcoming tax hikes or strengthening of tax-base rules.

By contrast to current-assessment reforms, later changes to a future-assessment regime are inherently retroactive with respect to deferred tax liabilities. This is because, under a future-assessment regime, any economic income or accruals to wealth will be “inchoate” until the time of realization. Thus, even if the tax when realized carries with it an interest

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159 To extend the metaphor, political optionality is like an “American” option, i.e., one that can be exercised at any time, rather than a “European” option, i.e., one that can be exercised only on its expiration date. See Black & Scholes, supra, at 637.
160 The concept of “inchoate income” is generally considered incoherent from the perspective of “economic income.” See, e.g., Simons, supra note 49, at 87. Nonetheless,
charge to cover the time-value benefits of deferral, any gain will, for purposes of tax law doctrine, still only be income in the year of realization.\textsuperscript{161} Consequently, if a future Congress lowers the tax rate or the interest rate that applies to that gain, this would implicitly have retroactive effects even though it would doctrinally only apply to that year’s and future years’ realized income.\textsuperscript{162}

Exacerbating all of these dynamics, ultra-wealthy taxpayers can and do lobby and exert other political pressures to increase the likelihood of future legal or political changes being favorable to them, so as to increase the option value they derive from the realization doctrine and from future-assessment reforms. In this manner, the time value of options interacts with and magnifies the other ways in which future-assessment reforms foster dynamics that tend to result in these reforms eroding over time.

3. Federal Budget Rules and Political Incentives

Fiscal institutions and budget accounting rules, though somewhat technical and arcane, have very real effects on the politics of tax law and tax reform. In particular, they can weaken future-assessment reforms in some surprising ways.

To see this requires first explaining a few basics of budget policy and revenue scoring. First, the Congressional Budget Office is required to “score”—i.e., providing a cost estimate of—bills and resolutions approved by Congressional committees.\textsuperscript{163} This is done using a combination of the CBO’s own methodology and the revenue estimates of tax bills produced by the staff of the Joint Committee on Taxation.\textsuperscript{164} That “score” is useful to legislators thinking about the overall budget, but also affects the enforcement of various budget rules and targets.\textsuperscript{165}

Second, one aspect of those budget rules is that revenue and cost

\textsuperscript{161} See, e.g., Weiss v. Wiener, 279 U.S. 333, 335 (1929); Jeffrey L. Kwall, When Should Asset Appreciation Be Taxed?: The Case for a Disposition Standard of Realization, 86 Ind. L.J. 77 (2011) (discussing the history of the realization doctrine).

\textsuperscript{162} This is even more true—obviously so—for some reforms of loophole benefits, like the step-up in basis. If the step-up in basis is repealed one year and reinstated the next, the repeal would have had no effect on anyone who had not died in the interim period.


\textsuperscript{165} Id. at 2.
estimates generally only cover the “budget window” of, typically, the next ten years. Revenue and cost effects beyond those years don’t appear in budget estimates and are only relevant in a few circumstances.

Third, an important case when budget estimates outside the budget window are important is in the context of “budget reconciliation,” a process that allows budget-related bills to pass through expedited Congressional procedures (including denial of the Senate filibuster), provided however that the do not raise the budget deficit in any of the “out years” beyond the budget window. This is one reason, for example, why recent tax cuts have been written to only stay in effect for the ten years after passage—to avoid increasing the deficit in years eleven and beyond.

What does this mean for future-assessment reform? Suppose Congress passes a law that includes retrospective capital gains taxation for at least some assets, like shares in closely held corporations or interests in partnerships. Because that revenue would appear only in some future years, it would have a muted revenue estimate for budget scoring purposes—some of the revenue would likely show up only in the “out” years, and thus would not be part of the official revenue estimate. Recall that we are talking still about current economic income—the actual taxation of gain that occurs in year 1 might not happen until year 11, and therefore it would essentially have no budget effect, even if the ultimate tax would be the present-value equivalent of taxing in year 1. And given budget rules, like various caps and pay-as-you-go rules, it would be institutionally difficult to spend that money before it is actually collected.

If government accounting were more rational, that future tax revenue might at least show up as a deferred tax asset on the government’s balance sheet—as value that it would monetize in the future. If that were the case,

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166 Under law, a Congressional budget resolution must cover a window of the next five year, 2 U.S.C. § 632, but typical practice has been to estimate revenue and outlays over a ten year period, see, e.g., Congressional Budget Office, Budget and Economic Data, 10-Year Budget Projections, https://www.cbo.gov/about/products/budget-economic-data.


169 The federal government could of course borrow against that future revenue—the government has essentially unlimited borrowing capacity. But the associated spending would still show up as outlay without any offsetting revenue within the budget window.

170 See, e.g., U.S. GAAP ASC 740.
there might be a cost scored to future changes that destroyed the value of that asset. Alas, that is not the case.\footnote{See, e.g., U.S. Dep’t of the Treas., Fin. Rep. of the U.S. Gov’t 69 (2019), available at: https://fiscal.treasury.gov/files/reports-statements/financial-report/2019/FR-02272020(Final).pdf.} Instead, and perversely, Congress could pass a law that would lower the value of the tax asset—that is, would lower the total revenue likely to be collected over time—but would be scored as raising revenue (or at least lowering revenue less than it really does).\footnote{See, e.g., Joint Comm. on Tax’n, Estimated Budget Effects of the Conference Agreement for H.R. 4520, The “American Jobs Creation Act of 2004” (JCX-69-04) 5, line 22 (showing that a one-time 85% deduction for dividends received by a U.S. parent from a controlled foreign corporation would raise $2.8 billion for the year it was in effect, partially offsetting the projected revenue loss of $6 billion over the next nine years).}

For example, suppose Congress repealed a future-assessment tax that would have taxed gain at the present-value equivalent of a current-assessment tax, and replaced it with a current-assessment tax, but at a far lower tax rate. For budget purposes, Congress would have lost a lot of revenue in the out years—the years beyond the ten-year budget window—but added a little revenue within the budget window. The bill would be a net loser in present value, but could increase revenue estimates for budget scoring purposes. This is a dynamic we saw played out, for example, in the taxation of the foreign income of U.S. multinational corporations, discussed below.\footnote{See infra Subsection III.C.2.}

The reform need not be this dramatic for the same effect to exist. For example, Congress could keep the future-assessment tax in place but simply lower the tax rate or narrow the base that would apply upon realization. In a static setting, that would seem to lower revenue uniformly. But in a dynamic setting, the lower rate might induce some taxpayers to accelerate realization of their previously deferred tax liabilities inside the budget window, so as to take advantage of those reduced rates or narrowed base, again making it appear as if an overall revenue loser actually increases revenue.\footnote{This is the opposite of the problem with raising current capital gains tax rates (absent a current-assessment reform) as explained supra in notes 68–69 and accompanying text.}

The effect of these deferred tax assets (to the government) or liabilities (to taxpayers) goes beyond formal budget rules. The politics should be obvious—a tax cut that does not impact the budget for favored priorities is a win-win for most politicians. Moreover, as taxpayer deferred tax liabilities
accumulate, enforcement incentives change. In particular, taxpayers would inevitably come up with new tax gaming ideas for making use of their deferred tax liabilities, and the larger the amount of accumulated deferred tax liabilities, the more pressure there would likely be on the Treasury and IRS to be lax in policing these new forms of tax gaming.\textsuperscript{175}

By contrast, a current-assessment reform would immediately begin generating tax revenue. Then, subsequently reducing the tax rates or narrowing the base would be expensive because instead of reducing the value of the government’s deferred tax assets (a non-budgetary cost) there would be a reduction in current tax revenue that would directly affect budget scoring. Moreover, if that change were to also reduce tax revenue in the out years, it could not be passed through the expedited budget reconciliation process.

All of this adds up to asymmetric institutional pressures. A current-assessment reform, once passed, becomes somewhat sticky—repealing it would cost real money, in budget terms, and face a more difficult legislative process with more stringent budget rules. By contrast, a future-assessment reform carries the seeds of its own diminution, since scaling it back or repealing it would appear to cost less in budget terms than it really does and could even score as increasing revenue. These asymmetric pressures magnify the political optionality benefits to taxpayers from future-assessment reforms, by making it substantially more likely that law or policy will move in the direction of reducing the future taxation of deferred tax liabilities.

Further exacerbating these asymmetric institutional pressures are the indirect effects related to the political incentives of building coalitions around the spending of tax revenues. This is because tax revenue generated today—such as through a current-assessment reform—can be used to fund public spending or other policy goals, which would likely then generate a political constituency with the motivation to defend this new revenue source.

We discussed above the typical dynamic of concentrated costs and diffuse benefits that characterizes repealing tax benefits for the ultra-wealthy.\textsuperscript{176} One way to counteract that, at least partially, would be to use

\textsuperscript{175} As Daniel Hemel has explained, political pressures tend to bias the Treasury Department and IRS toward using their regulatory authority mostly in taxpayer-favorable, revenue-losing directions, because doing so “will be quite attractive to the President: if his administration acts on its own to reduce taxes, the President will reap all the political benefits, while he and Congress will share the political costs of spending cuts.” Hemel, supra note 152, at 643.

\textsuperscript{176} See supra notes 147–152 and accompanying text.
the new revenue stream to create a constituency that would lose something if the new revenue source were lost. Yet a future-assessment reform, by contrast, would in most circumstances not be able to appropriate the tax revenues it might eventually raise until some theoretical future date. Of course, Congress could choose to borrow in advance of receiving that revenue. Indeed, that might be the financially rational thing to do, if the future revenue were assured. But, as noted above, budget accounting and budget politics do not generally provide for a clean way to do that. Thus, without a constituency directly benefitting from the future-assessment revenue stream, repeal would have diminished political cost—just as it would also have diminished budget cost.

B. Prior Future-Assessment Proposals

We believe there is a strong theoretical case for current-assessment reforms, compared to future-assessment reforms, as discussed in the prior subsection. However, the prior literature has generally concluded that more conventional (realization-based) future-assessment reforms should suffice for fixing the personal tax system, so that current-assessment reforms have typically been viewed as unnecessary and thus not worth pursuing.\footnote{See supra note 18.} To flesh out our theoretical argument, we now examine two prominent categories of future-assessment reforms in more detail: (1) retrospective capital gains tax reforms (including hybrids of partial mark-to-market and retrospective capital gains tax reforms), and (2) progressive consumption tax reforms.

We focus here in particular on reforms that address the time-value benefits of deferral, since these are the trickiest problems to solve. By contrast, there are numerous proposals for ending at least some of the major loophole benefits of deferral (the other category of existing-law benefits of deferral).\footnote{See id.} For example, repeal of the section 1014 step-up in basis would be relatively straightforward—at least in terms of legislative drafting. The primary obstacles instead are the political difficulty of accomplishing it, and then sustaining it. As we will explain below, the history of prior attempts to repeal the basis step-up illustrate the dangers of political optionality. And we believe those same dangers also arise with these more comprehensive future-assessment reform proposals that we will discuss below.

The reform proposals below would—if they remained politically stable—end (or, at least make irrelevant) the time-value benefits of deferral. However, as we will elaborate, these proposals would retain the political
optionality benefit of deferral. That is, because these proposals would continue to use realization as the time of tax assessment, the actual collection of tax would often occur in later time periods than when income is earned (or when wealth or spending power is accumulated). As a result, these proposals would be vulnerable to later political or legal changes undermining the actual collection of tax.

1. Retrospective Capital Gains Taxation

A realization-based tax system can, at least in theory, counteract the time-value benefits of deferral by instituting an additional charge at the time of realization that reflects the time value of money during the deferral period—essentially an interest charge that covers the time from when the income was earned to when it is taxed. The seminal modern proposal of this type came from Alan Auerbach. Auerbach’s proposal has since been praised and elaborated by many other academics and analysts.

Auerbach’s proposal is actually more nuanced than simply an interest charge. Prior retrospective proposals, especially that of William Vickrey in 1939, imagined knowing how much unrealized gain was earned in a given year, and thus how much tax would have been owed on realization. The government could then just treat that unpaid tax as a loan and charge interest accordingly, repeating each year. The catch, as Auerbach points out, is that this would require knowing the value of the asset at each point in time, which we often do not.

Auerbach suggested a different approach. He was primarily concerned with the lock-in effect—the incentive that taxpayers have, at any given moment in time, to hold an asset, thus deferring tax, rather than sell it and be taxed. The goal of Auerbach’s proposal was “holding-period neutrality,” i.e., a world where, at any given point in a time, taxpayers

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182 Indeed, in the current era, retrospective proposals are almost uniformly directed at illiquid assets, where annual accrual taxation would be too inaccurate. If the value is known, as with publicly traded assets, we can instead use mark-to-market schemes.
183 Auerbach, supra note 179, at 167.
would be indifferent between holding or selling assets.\textsuperscript{184} If the lock-in effect could be removed, that would eliminate some of the welfare costs of the realization doctrine. Auerbach demonstrated how to achieve holding-period neutrality with a formula that uses only the asset value at realization, the tax rate, the holding period, and the risk-free interest rate, and without needing to know asset values during the holding period. This formula computes a tax upon realization that increases the longer the holding period.\textsuperscript{185} 

Auerbach’s proposal was designed to avoid the liquidity and valuation problems that the prior literature has generally viewed as being the primary disadvantages of current-assessment reforms.\textsuperscript{186} As Auerbach has noted, however, retrospective capital gains taxation alone is not sufficient to end the existing-law benefits of deferral without other reforms, most importantly repealing the step-up in basis at death.\textsuperscript{187} This is because retrospective capital gains taxation cannot solve the problem of a legal rule that simply erases a large portion of the tax base.

But that limitation points at the larger problems caused by the political-optionality benefits of deferral. By leaving intact the taxpayer’s choice as to when the tax will apply (even if the amount of the tax is calculated so as to theoretically be timing neutral), retrospective capital gains tax reforms would allow taxpayers the option to wait for future legal changes beneficial to them.\textsuperscript{188}

The problems that the political optionality benefits of deferral pose for full retrospective capital gains tax proposals also apply to hybrids of partial

\textsuperscript{184} Id. at 169.

\textsuperscript{185} Id. at 170. In the simple case where there are no cash flows from the asset, just an increase in value, Auerbach’s formula for a tax liability at time \( s \) is \( T_s = (1 - e^{-t(i)}A_s) \), where \( t \) is the tax rate, \( i \) is the risk-free interest rate, and \( A_s \) is the value of the asset at time \( s \). Conceptually, the tax system taxes the investor as if the asset had grown at the risk-free rate to reach the value of \( A_s \). The idea is that at any given point in time, a rational investor should be indifferent at the margin before taxes between investing in a risky and a risk-free asset, which implies a risk-adjusted expected rate of return for the risky asset equal to the risk-free rate. If that is so, then telling the investor that they will pay tax in the future on that risk-free return regardless of whether they sell or hold should make them indifferent after taxes too.

\textsuperscript{186} Id. at 170. In the simple case where there are no cash flows from the asset, just an increase in value, Auerbach’s formula for a tax liability at time \( s \) is \( T_s = (1 - e^{-t(i)}A_s) \), where \( t \) is the tax rate, \( i \) is the risk-free interest rate, and \( A_s \) is the value of the asset at time \( s \). Conceptually, the tax system taxes the investor as if the asset had grown at the risk-free rate to reach the value of \( A_s \). The idea is that at any given point in time, a rational investor should be indifferent at the margin before taxes between investing in a risky and a risk-free asset, which implies a risk-adjusted expected rate of return for the risky asset equal to the risk-free rate. If that is so, then telling the investor that they will pay tax in the future on that risk-free return regardless of whether they sell or hold should make them indifferent after taxes too.

\textsuperscript{187} See Alan Auerbach, Reforming Capital Gains Taxation, 135 TAX NOTES 1399, 1399 (2012).

\textsuperscript{188} Auerbach’s version of retrospective capital gains taxation has other problems as well. A large one is that it taxes from an ex ante perspective rather than ex post, meaning that those who ended up with especially large extra-normal returns would end up being taxed relatively lightly as a percentage of their actual gains. See Auerbach, supra note 179, at 176–77. This is especially concerning if our motivation is to more effectively tax the ultra-wealthy—by definition, the big ex-post winners.
mark-to-market and retrospective capital gains tax proposals. Most of the proposals in the prior literature for mark-to-market style reforms would actually only enact a partial mark-to-market system that would apply mostly just to publicly traded securities.\footnote{See Kleinbard, supra note 27, at 354 (“Nearly every such proposal limits its reach to publicly traded instruments ….”); supra note 136 (discussing Senator Wyden’s proposal of this sort).} With respect to other, harder to value assets, many of these proposals would then apply a retrospective capital gains tax reform.

However, taking account of the political optionality benefits of deferral, sophisticated taxpayers would almost certainly expect that future legal or political changes would eventually undermine the retrospective capital gains tax component of such a reform, so that sophisticated taxpayers would likely still face large incentives to shift their investments away from assets subject to the mark-to-market component of the reform toward those subject to retrospective capital gains component. For this reason, although a hybrid of a partial mark-to-market and a retrospective capital gains tax reform might perhaps be better than nothing, we doubt that such a reform could succeed at fixing how the income tax is currently broken.

2. Progressive Consumption Taxation

An alternative realization-based approach for eliminating the time-value benefits of deferral involves abandoning the attempt to tax time-value returns altogether. Various approaches for progressive consumption tax reform proposals have been designed to accomplish this, with specific versions of these proposals often labeled as personal expenditure tax reforms, progressive spending tax reforms, and cash flow consumption tax reforms, among other labels.\footnote{E.g., Victor Thuronyi, A Supplemental Expenditure Tax for Canada, 67 CANADIAN TAX J. 711, 711 (2019) (“cash flow consumption tax”); Edward J. McCaffery & James R. Hines, The Last Best Hope for Progressivity in Tax, 83 SOUTHERN CALIF. L. REV. 1031, 1031 (2010) (“progressive spending tax”); Alan D. Viard, Fundamental Tax Reform: A Comparison Of Three Options (November 5, 2015) (“personal expenditure tax”) (working paper, on file with authors).}

Although specific design elements vary, these different consumption tax proposals generally share two key features: first, including in the tax base only funds used for consumption, at the time that these funds are used for consumption; and second, eliminating the tax on the risk-free time-value returns to holding wealth.\footnote{Under most versions of these sorts of reform proposals, supernormal returns (or “economic rents”) would still be included in the tax base. Many commentators also argue} By taxing funds only once when withdrawn to
fund consumption, the ultimate tax is the same in present-value terms no matter when the funds are withdrawn, thereby eliminating any financial time-value benefits to deferral.

Furthermore, well-designed consumption tax reform proposals would generally also change the tax rules governing borrowing, so that borrowing money to fund consumption would generate the same tax as would selling assets to fund consumption. Thus, taxpayers like Larry Ellison (who, as we previously explained, has funded around $10 billion of untaxed consumption through borrowing) should face much higher effective tax rates under a well-designed progressive consumption tax than under the existing income tax.

However, as with retrospective capital gains taxation, progressive consumption tax reforms would retain the realization-based nature of the personal tax system, by allowing for separation in time between the point at which the power to spend is accumulated and when it is taxed. This thus retains the political-optionality benefits of deferral.

It may perhaps seem odd to describe a tax on current consumption as being a future-assessment reform. But because consumption generally occurs at a point after income has been earned, and thus also after the power to spend has been accumulated, a consumption tax is assessed in the future with respect to both income and the accumulation of spending power. We can thus analytically distinguish the base that is to be taxed over a taxpayer’s lifetime (here, total lifetime consumption) from the points in time at which that tax is to be assessed and collected. The typical consumption tax proposal uses the times when actual consumption occurs to impose tax, but we could imagine a current-assessment version of a progressive consumption tax that instead imposes tax at the times in which spending power accumulates.

that “risky returns” do not face an effective tax burden under an income tax and therefore can be ignored, though this is not a universal view. See John R. Brooks, Taxation, Risk, and Portfolio Choice: The Treatment of Returns to Risk Under a Normative Income Tax, 66 TAX L. REV. 255 (2013).

192 This is often held out as a major advantage of progressive consumption taxation over income taxation—one could not pursue the usual buy-borrow-die strategy. See, e.g., McCaffery, supra note 10, at 878–80.
193 See supra notes 1–9 and accompanying text.
194 By delaying when money received is used to fund consumption, a taxpayer can create a separation in time between when money is received by the taxpayer and when that money is realized and reported as taxable under a consumption tax. This is still deferral and allows the taxpayer to defer tax while waiting for favorable (to the taxpayer) future legal changes. Whether we call this receipt of money “income” or “wealth accumulation” or something else, the key is that taxpayers can receive money along with control of that money, and then defer any tax on those receipts by delaying consumption.
Thus, to transform any of the major progressive consumption tax reform proposals into a current-assessment reform, all that is needed is to add a pre-payment or withholding mechanism that would assess and collect tax as the power to spend accumulates. These pre-paid or withheld (currently-assessed) tax payments could then be reconciled with the final assessment of tax that could be calculated when funds are withdrawn to pay for actual consumption.195

Because the progressive consumption tax proposals in the prior literature lack such mechanisms, we label them future-assessment reforms. Thus, under any of these proposals, a taxpayer could just wait for a tax rate reduction or a narrowing of the tax base before withdrawing funds for consumption and thereby subjecting those funds to tax. Because taxpayers could opt to postpone withdrawing funds for consumption until a later period, they could simply wait for a more favorable Congress or IRS. To be sure, many taxpayers have much less ability to defer actual consumption than they do to just defer realization under the rules of the existing income tax. Thus, strategic deferral might be somewhat less available as a tax planning strategy under a well-designed progressive consumption tax than under either the existing income tax or a retrospective capital gains tax. Indeed, this is part of the normative arguments typically made in favor of using consumption as a tax base.196

However, the ultra-wealthy differ from more ordinary taxpayers and—almost by definition—have more wealth than they are likely to ever consume. Many of the ultra-wealthy would thus be able to strategically time at least large portions of their withdrawals following any of these progressive consumption tax reforms. In particular, future heirs would have a strong incentive to lobby hard for future rate changes or exemptions, knowing that most of their consumption would come in later time periods.

Thus, the likelihood that future consumption would eventually come to be taxed at a lower effective rates, due to political or legal changes, would almost certainly lead many ultra-wealthy taxpayers to defer substantial portions of their tax liabilities. This would then result in essentially the same dynamics as with retrospective capital gains tax reforms,197 although

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195 We plan to elaborate on how proposals of this sort could work in future scholarship. Daniel Hemel has previously explained how a pre-payment or withholding mechanism of this sort could work in the context of a retrospective capital gains tax reform. Hemel, supra note 30, at 768–69.


197 Edward Kleinbard has made a limited version of this argument in a few paragraphs of his prior work (Kleinbard, Right Tax, supra note 27, at 232–33). In particular, Kleinbard focuses on the concern that, following the enactment of a progressive consumption tax
perhaps to a comparatively lesser degree.\textsuperscript{198}

\textbf{C. Historical Examples of Political Optionality in Action}

To further explain why we are skeptical of future-assessment reforms that would leave intact the political optionality benefits of deferral, we next discuss lessons that can be drawn from tax history. Specifically, we consider three sets of historical examples where political optionality undermined important aspects of the tax system: a) capital gains tax rate fluctuations, b) tax holidays related to the repatriation of foreign-source income, and c) stepped-up basis reform efforts.

Each of these historical examples illustrates a slightly different aspect of the problems posed by the political optionality benefits of deferral, and together they tell a strong cautionary tale against any reform that would act to limit only the existing-law benefits of deferral without also limiting the political optionality benefits of deferral. Specifically, the history of taxpayer responses to capital gains tax rate fluctuations reveals the extent to which taxpayers can be expected to change their behavior in response to future legal changes and even just the possibility of such changes. The history of the repatriation of the foreign-source income of controlled foreign corporations then clarifies how the political optionality benefits of deferral on their own (even in the absence of any existing-law benefits of deferral) can create powerful incentives for taxpayers to defer realizing income. And, finally, the history of attempts at reforming the provision for stepped-up basis shows the unsustainability of attempting to end the major loophole reform, Congress would see large amounts of invested wealth build up and not spent/realized, and so would then be unable to resist the temptation to create tax holidays, especially during economic downturns. We agree with Kleinbard on this point, but we view this as only a portion of the broader problems that the political optionality benefits of deferral pose for progressive consumption tax reforms. As we explained in subsection III.A.1, inertia and drift are the dominant feature of tax politics, and it is thus much easier for a coalition to defeat attempts to modify previously enacted tax reforms than to create new modifications. Consequently, what is likely to be the most important dimension of the problems that the political optionality benefits of deferral pose for progressive consumption tax reforms arises from the near inevitability of taxpayers eventually devising tax-gaming stratagems capable of granting them access to their deferred tax liabilities without triggering tax, followed by a failure to adequately police these stratagems. For some examples of how this could happen, see Gamage, supra note 65, at 428–29.

\textsuperscript{198} Whether a progressive consumption tax reform would result in these sort of dynamics to a comparatively lesser, or a comparatively greater, degree is hard to say, and would depend on the design of the progressive consumption tax reform, among other factors. Notably, many of the most prominent proposals for progressive consumption tax reforms would involve full expensing, which would result in much greater deferral of tax liabilities as compared to either the existing income tax or a retrospective capital gains tax.
benefits of deferral absent current-assessment reforms, and, more generally, how reform attempts that would rely on future assessment can be highly vulnerable to political attack.

1. Capital Gains Tax Rate Fluctuations

Legislators regularly tinker with tax rates, whether to achieve revenue targets, distributional goals, constituent demands, economic incentives, or other goals. This includes not just tax rates on capital gains, but also ordinary income, corporate income, and more. Indeed, rates on ordinary and corporate income have varied over a wider range than capital gains. Since 1981, the top statutory marginal rate on ordinary income has varied between 28% and 50%, and the top corporate rate has varied between 46% and 21%. In that same period, the top capital gains rate has fluctuated between 15% and 29%. 199

Nevertheless, due to the realization doctrine, we should expect capital gains rate changes to influence behavior far more than changes to ordinary income or corporate income. This is because it is relatively easy to shift the timing of capital gains realization forward or backward to maximize tax benefits, but harder to do so for most business and salary income. And, indeed, past experience with rate changes have shown that there is a relatively high elasticity (that is, taxpayer responsiveness) of capital gains realizations to the tax rate, particularly from transitory rate changes. 200 In other words, taxpayers—and especially sophisticated taxpayers—clearly do plan their capital gains realizations strategically in the face of rate changes. 201

For example, in 1987 the capital gains rate went up from 20% to 28%, and as a result, capital gains realizations spiked in 1986, the year before the increase, and then dropped to an even lower level during the 1987–1997 period. 202 We saw similar behavior in 2012, the year before the 15% capital gains tax rate increase.

199 After the Tax Reform Act of 1986, there was even a 33% “bubble rate” that applied to taxpayers just below the highest income group, intended to offset the advantages of the lower marginal rates on smaller income amounts. See Tax Reform Act of 1986, Pub. L. No. 99-514, § 302(a), 100 Stat. 2085 (1986). This was intended to achieve the effect of a flat 28% for the higher income groups, and so we treat 28% as the top rate for that period.


gains rate increased to 20%. Same for 2017, as taxpayers assumed that rate cuts or other tax breaks would be coming in that year’s tax reform bill. Sophisticated taxpayers—who hold most of the capital gain–producing assets—have repeatedly shown that they will time realizations based on anticipated tax changes.

The regular fluctuation of capital gains tax rates also reveals a different—but related—type of behavior. David Kamin and Jason Oh apply a similar analysis as we do here to argue that capital gains rate uncertainty itself generates a return to deferral, because of the option value of a potential future lower rate. They argue, for example, that if the current capital gains rate is relatively high, then a taxpayer might reasonably guess that in a future year, the rate could revert toward the historical mean, thus creating an incentive to defer realization until that future year. When the taxpayer has a long time horizon, the likelihood of some future year having a lower rate increases, thus also increasing the incentive to wait. How much this behavior occurs in practice is an empirical question that requires further study, but the logic is compelling and dovetails with other common tax planning strategies, such as deferring compensation until future, lower tax–bracket years.

2. Repatriation Holidays

A similar option value to waiting is at play in the choices of multinational corporations for when to “repatriate” the income earned by their foreign subsidiaries back to the U.S. parent corporation. Because even related corporations are treated as separate legal entities, the income earned by a controlled foreign corporation (CFC) does not become U.S. source income of the parent corporation until the subsidiary actually pays a dividend to the parent. Prior to 2018, that decision carried heavy tax

203 Id.
204 See, e.g., Max Ehrenfreund & Damian Paletta, Americans Are Taking Their Sweet Time Paying Taxes, and the Government is Running out of Cash, WASH. POST, June 1, 2017.
205 See supra Section I.A.
206 Kamin & Oh, supra note 30.
207 Kamin and Oh also introduce the step-up in basis into their model. If a person if close to death, there is much less uncertainty about the future capital gains rate, since it will be 0% shortly. That decreases the uncertainty, but increase even more the incentive to wait, as we discuss below. If anticipated death is farther away, a taxpayer might decide to take advantage of a low-rate year in the interim. Id. at 19–20.
208 This is the primary reason a person would choose a traditional 401(k) or IRA plan over a “Roth”-style 401(k) or IRA plan, for example.
209 See, e.g., DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION 31–32
consequences, analogous to the realization doctrine for capital gains—by simply not having the CFC distribute a dividend to the U.S. parent, the U.S. parent could avoid paying current U.S. tax.

As with the capital gain income of U.S. individuals, the timing of a repatriation dividend was almost entirely voluntary. There is little non-tax cost from failing to repatriate—if the parent corporation needs capital, for example, the fact that it had off-shore cash holdings makes it easier to raise money in the capital markets. And in the case of public companies, shareholders need not wait for a dividend to get access to the profits, since they could just sell shares on the market instead (or borrow against the shares, as described above).

But the repatriation case also departs from the individual capital gains case in an important way. In the case of individual capital gains, deferral also generates a time-value financial benefit. As we’ve discussed, that existing-law benefit is on top of the political-optionality benefits of also waiting for a favorable legal change. With repatriation, however, the time-value benefits of deferral were often not present—all that was available to multinational corporations in many circumstances were the political-optionality benefits. Yet this was still more than enough to dramatically affect their behavior.

Tax scholars have shown that, if a business enterprise faces a similar corporate tax rate and access to investment in the foreign jurisdiction as in the U.S., then there really is not a time-value financial benefit of deferring repatriation.\(^\text{210}\) This is because the cash in question would be earning a similar return while being held by the CFC, and that return would be taxed at a similar rate in the interim. Moreover, when the dividend was finally paid, it would be larger (by the after–foreign tax rate of return), and thus so also would be the tax collected on that dividend. It can be shown with simple math that this is equivalent to repatriating the dividend earlier, and then investing that cash in the U.S.\(^\text{211}\) The only factors that matter are the rates of return and the tax rates in the two jurisdictions, not the timing of the dividend.

For sure, multinationals have been quite aggressive about lowering their effective foreign tax rates, through international structuring or simply housing the CFC in a low- or no-tax jurisdiction. But the evidence shows that multinationals were also keeping cash offshore even in high-tax jurisdictions.\(^\text{212}\) Why was that, if in fact there were no time-value financial

\(^\text{210}\) Id. at 82–84.
\(^\text{211}\) Id.
\(^\text{212}\) Id. at 85–87.
benefits from doing so?\textsuperscript{213}

The answer, of course, comes from the political optionality benefits of deferral. In 2004, when U.S. corporations had perhaps $500 billion of cash held in offshore subsidiaries,\textsuperscript{214} Congress enacted a repatriation “holiday,” a low 5.25% tax rate on dividends paid by CFCs during 2005 and 2006 (as opposed to the then-existing 35% tax rate on corporate income).\textsuperscript{215} Congress’s theory was presumably that a one-time holiday would allow the offshore cash to come home and be reinvested in the United States\textsuperscript{216} (notwithstanding the fact that much of that cash was already in dollar-denominated accounts at U.S. banks, and often invested in U.S. Treasuries).\textsuperscript{217} And if corporations were told it was a one-time holiday, they would change their behavior going forward and not keep hoarding cash offshore.

The foreseeable result, however, was that U.S. corporations instead became even more emboldened to aggressively hoard cash offshore after 2006 and to then start lobbying for yet another repatriation holiday. In effect, Congress had signaled that a future lower rate was politically possible, meaning that the probability-weighted expected future tax rate immediately decreased. By thereby increasing the political optionality benefit of deferral, Congress increased the likelihood that corporations would continue to delay repatriation. And indeed, even though around $360 billion was repatriated under this provision,\textsuperscript{218} offshore cash holdings quickly shot back up, exceeding $2 trillion by 2017.\textsuperscript{219}

\textsuperscript{213} Another possible explanation is that there was an accounting benefit to keeping money offshore if the corporation could claim that the money was “permanently reinvested income.” In that case, there would not be current tax charge for the deferred income, thus giving a boost to reported earnings. \textit{Id.} at 86.


\textsuperscript{215} American Jobs Creation Act of 2004 §422(a), Pub. L. No. 108-357, 118 Stat. 1418, 1514–19. The new section 965 providing for an 85% dividends received deduction, meaning that only 15% of repatriated dividends were subject to the then-current corporate tax rate of 35%. That is equivalent to a 5.25% tax rate on 100% of the dividend.

\textsuperscript{216} See, e.g., H.R. Rep. 108-548(1), at 146.


\textsuperscript{219} See Institute on Taxation and Economic Policy, Fortune 500 Companies Hold a Record $2.6 Trillion Offshore (March 2017), available at: https://itep.org/fortune-500-
The corporations’ bet on the political optionality benefits of deferral ultimately paid off. Congress came close to passing another repatriation holiday in 2009, but then in 2017 enacted a holiday as a part of the general shift to a modified territorial regime. The huge influx of cash to U.S. parent corporations that followed was the likely cause of the burst of share repurchases during 2018.

Because of the shift to a modified territorial regime—that is, one in which foreign-source income, such as the profits of a controlled foreign corporation, are taxed only in the source jurisdiction—we may not see this pattern repeated in the future, at least to the same degree. But we nevertheless look to this example to highlight that the political optionality benefits of deferral are real and can dramatically affect taxpayer behavior in predictable ways. If a person or corporation can easily choose when to realize income, and if there is even a chance that the effective tax rate on that income will be lower in the future than today, the strategic choice is obvious and easy to implement. Moreover, when the taxpayer’s own behavior can affect the likelihood of a future lower rate coming about—through lobbying or other political activity—it becomes even more clear what the taxpayer will likely do.

3. Stepped-Up Basis Reform Efforts

As we have noted repeatedly, Section 1014’s provision for stepped-up basis upon death is perhaps the most important of the loophole benefits of deferral under existing law. Because of that provision, if an individual or family taxpayer can avoid realizing gains during their lifetimes, the gain will be wiped out at death when the asset is passed to the taxpayer’s heirs.

The problematic nature of Section 1014 is well known, and few defend it on a normative basis. Stanley Surrey, for example, called it “the most serious defect in the federal tax structure” 50 years ago. And, in theory, the solution is simple: just replace the basis step-up with a carryover basis regime, as already exists for gifts made during a donor’s life.
life, or, alternatively, treat death as a realization event for the decedent. Such reforms have been proposed numerous times over the years, and have even been partially enacted—yet they never last.

As Larry Zelenak and others have noted, under the original income tax in 1918 all transfers by gift or bequest resulted in a step-up in basis, though this was because of Treasury guidance, not because of any statutory law. In the Revenue Act of 1921, Congress then created the current split treatment, with a carryover basis for *inter vivos* gifts but codifying the step-up at death. At that time, the primary argument for the step-up at death was to avoid double taxation when most applicable taxpayers were also subject to the estate tax. Because there was no federal gift tax at the time, the issue cut the other way for *inter vivos* gifts—a carryover basis rule allowed for income taxation of gifts, since they were not included in the estate tax.

So the particular reform put in place in 1921 had a logic to it at the time. But—as an illustration of the sort of policy drift that we discuss above—that logic became obsolete by at least by 1932, when the gift tax was added permanently, and certainly by 1944, when Congress made permanent the wartime expansion of the income tax, such that it went from covering 5% of households to 56% of households by 1946, and continuing to grow from there. Income taxpayers and estate taxpayers were no longer the same households, and gifts were no longer exempt from wealth-transfer taxes.

In 1942, Treasury tried to get Congress to enact a carryover basis provision, and in 1963 and again in 1969 Treasury (with Surrey as Assistant Secretary for Tax Policy) pushed a detailed realization-at-death provision instead, but in the face of opposition these proposals each went nowhere. In 1976, the first real change occurred, with a carryover basis provision (Section 1023) replacing Section 1014. The provision had a number of

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224 I.R.C. § 1015.
225 See Larry Zelenak, *The Tax-Free Basis Step-Up at Death, the Charitable Deduction For Unrealized Appreciation, and the Persistence of Error*, at 4-8, working paper on file with authors.
231 See Zelenak, *supra* note 225, at 40-42.
exceptions to carryover basis treatment, including for life insurance and annuity policies, and also provided a minimum basis of $60,000 (so still a pretty large step-up in 1976, even if not to full fair market value). The provision also provided a full exemption for up to $10,000 of property transferred. Despite these carve-outs (or perhaps because of them), the provision was quickly deemed unworkable, and its effective date was postponed to 1980, and then ultimately repealed in 1980 with retroactive effect. Industry groups, professional organizations, and even the tax bar put strong pressure on Congress for repeal during that period. Ultimately, the complaints about complexity and workability won the day and preserved this large benefit for owners of wealth.

Importantly for our theory and approach, the 1976 attempted reform reveals how the combination of incremental Congressional action and non-action often tilts in favor of non-taxation of deferred tax liabilities. As a part of the compromise to enact the carryover basis provision, Congress also increased the estate tax exemption, from $60,000 to $154,000, under the reasonable argument that much of that property would instead come under the income tax umbrella due to the carryover basis provision. But when the carryover basis provision was repealed, the higher estate tax exemption was kept in place—the whole effort thus ended up being a net benefit to wealthy taxpayers. A current-assessment reform would likely have avoided that perverse result.

The next (and only other) major attempt to repeal the step-up in basis came under the Bush tax cuts in 2001, which also provided for a slow phase-out and then repeal of the estate tax. When the estate tax was fully repealed in 2010, a new partial carryover basis provision (Section 1022) was to take effect—partial, because each decedent was entitled to $1,300,000 of aggregate basis increase, which could be spread among the property in the estate. Recognizing the original connection between the estate tax and the step-up in basis provision, the general consensus at the

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233 \textit{Id.} (proposed § 1023(b)(2) (definition of “carryover basis property”), (d) ($60,000 minimum basis)).

234 \textit{Id.} (proposed § 1023(b)(3)).


238 See \textit{supra} Section III.A.


240 \textit{Id.} (proposed § 1022(b)).
time continued to be that the two should come and go together, and so the price of estate tax repeal was also repeal of the basis step-up and the institution of a carryover basis regime.

Because the Bush tax cuts were passed using budget reconciliation, and therefore under the “Byrd Rule” could not raise deficits in years outside the 10-year budget window, the estate tax was scheduled to come back in full force in 2011, along with Section 1014. The hope of Congressional Republicans in 2001 was that a future Congress would make the estate tax repeal permanent, but that did not happen. As a result, Section 1022 would have only been in force for one year, 2010. Even that was too much, however, and the provisions were instead repealed. However, estates of those who died during 2010 could still elect to forgo both the estate tax and the step-up in basis—again illustrating the heads-I-win-tails-you-lose nature of post-enactment changes.

The broader lesson here is that the income tax almost certainly cannot be sustainably fixed just by calling for an end to stepped-up basis and the other major loopholes that allow taxpayers to wipe out their deferred tax liabilities. Even if these reform attempts were to be enacted, why should we expect them to be sustained? Both theory and history strongly suggest the opposite—that even if the major loophole benefits were to be ended, absent an accompanying current-assessment reform, ultra-wealthy taxpayers would just continue to defer their tax liabilities while lobbying for the loopholes to be restored (or perhaps for new loopholes to come into effect), and these efforts by the ultra-wealthy would ultimately win the day.

CONCLUSION

Parts I and II of this Article explained how the existing U.S. income tax is broken, especially with respect to the ultra-wealthy, and with many harmful consequences. Part III then argued that, because of the political optionality benefit of deferral, only current-assessment reforms are likely to

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241 See, e.g., MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 23 (2005). Proponents of estate tax repeal seem today to have ridded themselves of the need to have a consistent approach to these policies. Major estate tax repeal proposals no longer included a repeal of Section 1014 and institution of carryover basis. See, e.g., Death Tax Repeal Act of 2019, S. 215, 116th Cong. (2019).

242 See supra notes 167–168 and accompanying text.


245 Id. § 301(c).
succeed at repairing the income tax or otherwise fixing the personal tax system. Together, these Parts thus established the case for why a current-assessment reform is needed: the only way to effectively tax today’s income (or, alternatively, today’s accumulations of wealth or of spending power) is to tax it today.

This still leaves the question of “how”—how does one effectively impose a currently-assessed tax on investment income? We do not mean to minimize the challenges involved, although we will note again that there are already proposals in the literature that we think would do a reasonable job of addressing these challenges while enacting current-assessment reforms.\(^{246}\)

Advocates for future-assessment reforms or for maintaining the current tax system typically object to these current-assessment reform proposals by citing some combination of: (a) the administrative difficulties of taxing the accrued income from hard-to-value assets, (b) concerns about taxpayers having sufficient liquidity to pay periodic taxes, and (c) worries about the constitutionality of some federal-level current-assessment approaches that might be at risk of being considered “direct taxes.” Most of all, the opponents of current-assessment reforms have argued that alternative future-assessment approaches to reform are good enough so that there is no need to deal with these challenges.

We hope we have dealt with this latter complaint by explaining why future-assessment taxes are emphatically not good enough. But the former complaint remains—how do we deal with the problems of valuation, of liquidity, and of constitutionality?

With respect to the ultra-wealthy, we view liquidity as mostly a non-issue. If current-assessment reforms are directed at the ultra-wealthy, as we believe they should be, then reformers need not be much concerned about whether there are sufficient liquid assets to pay an annual tax on unrealized income. Arguably, there may be limited exceptions, but in those very limited scenarios in which liquidity may still be a significant concern with respect to some ultra-wealthy taxpayers (such as perhaps the founders of start-up companies) it is not overly difficult to build mechanisms into current-assessment reforms for resolving liquidity concerns in those specific scenarios.\(^{247}\)

The constitutionality and valuation challenges are potential more vexing, but scholarship on both issues has advanced considerably in recent years,\(^{248}\) such that in our view neither are insurmountable barriers. We will

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\(^{246}\) See supra notes 26-27.

\(^{247}\) See supra note 27

\(^{248}\) For an early draft of our views as to how a federal wealth tax or other current-
have more to say about both of these topics in subsequent work, but we hope that this Article also serves as a research agenda and a call-to-arms for tax scholars to continue to push forward to develop further innovative solutions.

Despite decades of endless discussions and tax reform efforts, the realization doctrine and the ability to defer income remain—the “original sin” of our tax system—eroding the fundamental fairness and effectiveness of our tax system and of our political economy more generally. We think that a major reason for this is that tax scholars and reform advocates have failed to appreciate the need for current-assessment reform. We have thus argued both that developing better current-assessment reform proposals should be at the top of the agenda for tax policy scholars and that pushing for the enactment of some approach for current-assessment reform should be at the top of the agenda for tax reform advocates.

Substantial tax reforms are hard to pass, and so if the next major tax reform fails to enact current assessment, we may not get another shot. Unless we aim to tax now, we may ultimately tax never.

assessment reform could be designed to ensure its constitutionality, see John R. Brooks and David Gamage, Why a Wealth Tax is Definitely Constitutional, available at https://ssrn.com/abstract=3489997 or http://dx.doi.org/10.2139/ssrn.3489997. For early drafts of some of our proposals for resolving valuation issues in designing a wealth tax or other current-assessment reform, see Gamage, Five Key Research Findings on Wealth Taxation, supra note 22. See also supra note 27, and also the proposals and drafts cited in note 26 supra.
SECTION 1. Part 27 (commencing with Section 50301) is added to Division 2 of the Revenue and Taxation Code, to read:

PART 27. WEALTH TAX

Chapter 1. General Provisions and Definitions

50301. This part shall be known, and may be cited, as the Wealth Tax Act.

50302. The collection and administration of the tax described in this part shall be governed by the provisions of Part 10.2 (commencing with Section 18401) unless expressly superseded by the provisions of this part.

50303. (a) The Wealth Tax shall be reported with, and is due at the same time as, the annual income taxes of a taxpayer under Part 10 (commencing with Section 17001). The Franchise Tax Board shall amend the Personal Income Tax Forms, and amend or create any other forms necessary, for the reporting of certain assets and of taxpayer’s worldwide net worth.

(b) As part of filing annual Personal Income Tax forms, every taxpayer required to submit such forms shall be required either to declare that their worldwide net worth is less than the relevant exemption threshold of 50305(a)(1) or else shall be required to submit the forms to be created by the Franchise Tax Board for reporting the taxpayer’s worldwide net worth.

(c) For purposes of reporting a taxpayer’s worldwide net worth, assets that must be reported separately shall include, but shall not be limited to, the following categories:

1. Stock in any publicly and privately traded C-corporation.
2. Stock in any S-corporation.
3. Interests in any partnership.
(4) Interests in any private equity or hedge fund.
(5) Interests in any other noncorporate businesses.
(6) Bonds and interest bearing savings accounts.
(7) Cash and deposits.
(8) Farm assets.
(9) Interest in mutual funds or index funds.
(10) Put and call options.
(11) Futures contracts.
(12) Art and collectibles.
(13) Financial assets held offshore.
(14) Pension funds.
(15) Other assets, excluding real property.
(16) Debts other than mortgages or other liabilities secured by real property.
(17) Real property.
(18) Mortgages and other liabilities secured by real property.
(d) For the avoidance of doubt, directly held real property, and mortgages and other liabilities secured by directly held real property, must be listed separately in accordance with subdivision (b), but those items are not considered in calculating the taxpayer’s worldwide net worth under this part pursuant to Section 50306.

50304. If any section, subdivision, paragraph, or provision of this part is found to be invalid, unconstitutional, or otherwise unenforceable that finding shall not affect any other section, subdivision, paragraph, or provision in this part that can be enforced without the use of the offending provision.

Chapter 2. Imposition of Tax on Wealth

50305. (a) For the benefit of accumulating excessive wealth in this state, there shall be imposed an annual tax of 0.4 percent upon the worldwide net worth of every resident in this state in excess of the following:
(1) For married taxpayers filing separately, fifteen million dollars ($15,000,000).
(2) For all other taxpayers, thirty million dollars ($30,000,000).
(b) (1) Except as explicitly provided for in this part, for
purposes of subdivision (a) worldwide net worth shall be calculated in the manner set for calculation of the Federal Estate Tax under Chapter 11 (commencing with Section 2001) of Subtitle B of the Internal Revenue Code as that chapter reads as of December 31, 2020.

(2) Except as otherwise provided in this part, and only to the extent allowable under the California Constitution, United States Constitution, and other governing federal law, worldwide net worth shall be the value of all worldwide property owned by the taxpayer on December 31 of each year. Any transaction, a primary purpose of which is to reduce the valuation of a taxpayer’s worldwide net worth as of December 31, shall be disregarded. The Franchise Tax Board shall adopt regulations designed to prevent the avoidance or evasion of the tax imposed under this Part.

50306. (a) Worldwide net worth shall not include any real property directly held by the taxpayer. However, worldwide net worth shall include the value of real property held indirectly, as through a corporation, partnership, limited liability company, trust, or other such legal form, except to the extent that such inclusion is prohibited by the California Constitution, by the United States Constitution, or other governing federal law.

(b) Worldwide net worth shall include all personal property held directly by a taxpayer to the extent permitted by Article XIII, Sec. 2 of the California Constitution.

50307. (a) For purposes of this Part, “related persons” shall mean any person that is related to the taxpayer under either Section 267 or Section 318 of the Internal Revenue Code as those Sections read as of December 31, 2020, plus any other person so specified via regulations adopted by the Franchise Tax Board.

(b) Any assets of a child to who would be considered a “child to whom subsection applies” under the rules of Section 1(g) of the Internal Revenue Code, as that Section read as of December 31, 2020, that are in excess of fifty thousand dollars, shall be deemed to be assets of the parent or parents of such child following the rules of Section 1(g)(5) of the Internal Revenue Code as that Section read as of December 31, 2020.

(c) For purposes of determining the deductibility of any liability under subparagraph 50308(b)(6), below, a “related person” shall also include any
organization with respect to which the taxpayer would be considered a “disqualified person,” as that term is defined in section 4946 of the Internal Revenue Code, and regulations thereunder, as that Section and regulations read as of December 31, 2020.

50308. The Franchise Tax Board shall adopt regulations on the following subjects to clarify valuation methods.

(a) Annual Publication of Estimated Economy-wide Normal Rate of Return: Following the beginning of each tax year, the Franchise Tax Board shall publish the Estimated Economy-wide Normal Rate of Return for the prior tax year, based on the best available methodology. In the initial year in which this Part goes into effect, the Franchise Tax Board shall also publish the Estimated Economy-wide Normal Rate of Return for each of the prior ten tax years. Unless the Franchise Tax Board determines that some other methodology is more appropriate for a year or for a set of years, the Estimated Economy-wide Normal Rate of Return for each year shall be determined by adding 300 basis points to the rate of return on the most appropriate one-year United States Treasury Bill for that year.

(b) Valuation Methods and Additional Taxpayer Reporting Requirements.

(1) For all publicly traded assets, the value of the asset shall be presumed to be the asset's market value at the end of the tax year.

(2) For all sole proprietorships, all assets owned by or held through a sole proprietorship shall be reported and valued as though they were directly owned and held by the taxpayer not through a sole proprietorship.

(3) For all interests in any business entities other than sole proprietorships—including all equity and other ownership interests, all debt interests, and all other contractual or non-contractual interests—that are not governed by (b)(1) of this subdivision:

(A) The taxpayer shall report annually all of (i) the percentage of the business entity owned by the taxpayer, (ii) the book value of the business entity according to generally accepted accounting principles, and (iii) the book profits of the business entity in the tax year according to generally accepted accounting principles. If such reporting is impossible because the taxpayer lacks information on the book value or the book profits of the business entity and also lacks the right to obtain such information, then the taxpayer must instead submit a certified appraisal of all of the taxpayer’s interests in the business entity and must include the value derived from that certified appraisal in the taxpayer’s wealth
tax base for the tax year. A taxpayer is exempt from these requirements with respect to the taxpayer’s interests in a business entity only if all of the following conditions are met: (i) the taxpayer has received neither any information reporting from the business entity (as specified in Section 50309 of this Part) nor any other communications from the business entity sufficient for estimating even a minimum plausible value for the taxpayer’s interests in the business entity, (ii) the taxpayer lacks the legal rights to obtain such information reporting or other communications from the business entity, and (iii) the taxpayer declares that the total value of all of the taxpayer’s interests in that business entity are de minimis. For the purposes of this subdivision, a taxpayer’s interests in a business entity are only considered to be de minimis if the total value of all of the taxpayer’s interests in the business entity--but not including any rights to receive reasonable future compensation for future work or future services to be performed by the taxpayer--sum to less than fifty thousand dollars. For purposes of assessing whether a taxpayer’s interests in a business entity are de minimis, any rights of related persons shall be deemed to be rights of the taxpayer.

(B) Definition of Proxy Valuation Formula for Business Entities: for purposes of this Part, for any instance in which a valuation is to be calculated by the proxy valuation formula for business entities, such valuation shall be the book value of the business entity according to generally accepted accounting principles plus 7.5 times the book profits of the business entity for the tax year according to generally accepted accounting principles. However, if the taxpayer can demonstrate with clear and convincing evidence that a valuation calculated via the proxy valuation formula would substantially overstate the value as applied to the facts and circumstances for any year or set of years, then the taxpayer can instead submit a certified appraisal of the value of the taxpayer’s ownership interests in the business entity for that year or set of years and then use such certified appraisal value in place of applying the primary valuation rules of either (D) or (E).

(C) Determining the Percentage of the Business Entity Owned by the Taxpayer: For any interests that confer voting or other direct control rights, the percentage of the business entity owned by the taxpayer shall be deemed to be no less than the taxpayer’s
percentage of the overall voting or other direct control rights. For any interests that confer rights to the taxpayer in excess of the rights associated with such voting or other direct control rights, including rights for any potential future payments, potential future services, or other valuable receipts potentially obtainable from the business entity—regardless of whether these rights be contingent or noncontingent, and regardless of whether these be in the form of equity rights, debt rights, or other contractual or noncontractual rights, but not including any rights to be paid reasonable compensation for future work or for future services to be provided by the taxpayer or by an entity controlled by the taxpayer—unless the total value of all of the taxpayer’s interests in the business entity are de minimis under the definition in (3)(A) of this subdivision, the taxpayer must submit a certified appraisal for the estimated excess of the value of all such rights above the value of the taxpayer’s voting or other direct control rights and that excess must then be added to the valuation derived from the taxpayer’s voting and other direct control rights in assessing the taxpayer’s worldwide net worth for the current tax year for purposes of calculating the taxpayer’s wealth tax base for the year. For purposes of applying this subdivision, any rights of related persons shall be deemed to be rights of the taxpayer, unless the taxpayer submits evidence that the related persons both reported and paid wealth tax on such rights either to California or to another U.S. state or other U.S. jurisdiction.

(D) Primary Valuation Rule for Smaller Businesses: For business entities for which the valuation calculated by the proxy valuation formula for business entities is less than fifty million dollars, the value of the taxpayer’s ownership interests in the business entity will be presumed to be the percentage of the business entity owned by the taxpayer multiplied by the valuation calculated by the proxy valuation formula for business entities.

(E) Primary Valuation Rule for Larger Businesses: For business entities for which the valuation calculated by the proxy valuation formula for business entities is fifty million dollars or greater, the taxpayer must submit a certified appraisal of the value of the taxpayer’s ownership interests in the business entity. The value of the taxpayer’s ownership interests in the business entity will then be presumed to be the greater of either (i) the certified appraisal
value or (ii) the percentage of the business entity owned by the taxpayer multiplied by the valuation calculated by the proxy valuation formula for business entities.

(F) Prospective Formulaic Alternative Minimum Valuation Rule:
Notwithstanding (B) through (E) of this subdivision, if at any time within the past ten years there has been a sale, partial sale, or any other event that sets the value of the taxpayer’s interests in a business entity based on an arm’s length transaction, unless the total value of all of the taxpayer’s interests in the business entity are de minimis under the definition in (3)(A) of this subdivision, the taxpayer must report the valuation derived from that arm’s length transaction and then adjust that valuation by the annual published Estimated Economy-wide Normal Rates of Return for each year or partial year since the transaction took place, after also making any proper adjustments for withdrawals from or contributions to the business entity. If, in any year, the valuation calculated via this Prospective Formulaic Alternative Minimum Valuation Rule exceeds the valuation calculated based on the relevant primary valuation rule or reported based on a certified appraisal, then the valuation calculated via the Prospective Formulaic Alternative Minimum Valuation Rule shall supercede the valuation calculated based on the primary valuation rule or reported based on a certified appraisal, unless the taxpayer can demonstrate with clear and convincing evidence that the valuation calculated via the Prospective Formulaic Alternative Minimum Valuation Rule would substantially overstate the value as applied to the facts and circumstances.

(G) Retrospective Formulaic Alternative Minimum Valuation Rule:
Notwithstanding (B) through (F) of this subdivision, if in any year there is a sale, partial sale, or any other event that sets the value of the taxpayer’s interests in a business entity based on an arm’s length transaction, and if the valuation set by this arm’s length transaction exceeds the valuation reported and used by the taxpayer in any prior year, after adjusting by the annual published Estimated Economy-wide Normal Rates of Return for each year or partial year between the transaction and the valuation reported and used by the taxpayer in the prior year, and also after making any proper adjustments for withdrawals from or contributions to the business, then the Retrospective Formulaic Alternative
Minimum Valuation Rule shall apply, unless the total value of all of the taxpayer’s interests in the business entity are de minimis under the definition in (3)(A) of this subdivision or unless the taxpayer can demonstrate with clear and convincing evidence that the valuation calculated via the Retrospective Formulaic Alternative Minimum Valuation Rule would substantially overstate the value as applied to the facts and circumstances of the business for the year or set of years in question. For any year in which the Retrospective Formulaic Alternative Minimum Valuation Rule applies, the taxpayer must report the excess of the valuations calculated via the Retrospective Formulaic Alternative Minimum Valuation Rule over the valuation used by the taxpayer in each relevant prior year, and then adjust these excess valuations by the annual published Estimated Economy-wide Normal Rates of Return for each year or partial year and also after making any proper adjustments for withdrawals from or contributions to the business. The taxpayer must then add these adjusted excesses to the taxpayer’s worldwide net worth for the current tax year for purposes of calculating the taxpayer’s wealth tax base for the year.

(H) Definition of entity tax year: For purposes of this subparagraph (3), the tax year of a business entity shall be the tax year of the entity ending within or with the applicable tax year of the taxpayer.

(4) For all interest bearing savings accounts, cash, foreign currency, and other deposits, the value of the assets will be presumed to be their dollar value at the end of the tax year.

(5) For all interests in trusts:

(A) At the election of any trust, whether domiciled in California or otherwise, such trust may be taxable under this Act as if it were an individual, except that for purposes of determining worldwide net worth of the trust, section 50305(a)(2) shall be applied as though the number zero replaced the number thirty million;

(B) in the case of a trust beneficiary whose interest does not depend on the outcome of uncertain future events, such as the exercise of discretion by the fiduciary or the income of such trust, the assets of any trust shall be taxable to such beneficiary as if all the beneficiary’s interests in such trust, other than those that depend on uncertain future events, were owned by the beneficiary, but no beneficiary shall be taxable on any trust asset in
a given year to the extent such asset is taxed under this Act for that year to the trust;

(C) in the case of a beneficiary of a trust whose interest depends on the outcome of uncertain future events, such as the exercise of discretion by the fiduciary or the income of the trust, the beneficiary shall be taxable on such trust assets as though the owner of those assets to the extent that such assets are distributable to the beneficiary, whether distributed or not;

(D) To the extent permitted by the United States Constitution and the Constitution of California, the assets of any trust shall be taxable to the grantors of such trust, but a trust grantor shall not be taxable on any trust asset in a given year to the extent such asset is taxed under this Act for that year to the trust or to any beneficiary of the trust;

(E) in the case of a trust with more than one grantor, where the assets are taxable to one or more grantors, each asset of the trust shall be taxable to each grantor proportionately, where such proportion shall equal the ratio of the net value of the grantor’s contributed assets and any appreciation thereon still owned by trust, all over the total net assets of the trust, and where for purposes of this calculation any liabilities incurred or distributions or purchases by the trust are deemed to have been made out of contributed or appreciated funds in the same such proportion as existed at the time of the liability, distribution, or purchase;

(F) throwback rule for contingent beneficiaries: in the case of a beneficiary of a trust whose interest depends on the outcome of uncertain future events, such as the exercise of discretion by the fiduciary or the income of the trust, in any year in which a portion of the trust assets become distributable to the beneficiary, whether distributed or not, there shall additionally be a throwback tax imposed on such assets for each prior year in which such beneficiary was both a California resident and a potential beneficiary of such trust or its predecessor trusts, but in no case for a year prior to the effective date of this statute; except that in the case in which an electing grantor, as described in subparagraph I below, has already been taxed on a given asset for a given year, no throwback liability shall accrue for a beneficiary with respect to that asset in that year;

(G) rule for throwback valuation: in the case of a throwback tax being imposed, the amount of such tax shall be the amount of tax that would be due if taxpayer’s worldwide net worth for each applicable prior year were incremented by the discounted value of the trust assets that became
distributable in the current tax year, where such discounted value shall be calculated using the annual published Estimated Economy-wide Normal Rates of Return for each relevant year or partial year, and such throwback tax shall be further increased by an amount equal to the amount of interest that would have accrued between the applicable year and the current year, had such taxpayer incurred such incremented tax liability in the applicable year;

(H) for any year in which a grantor is subject to tax with respect to any trust asset, the grantor may elect to forego any potential refund otherwise available under subparagraph I below, but such election shall not be effective with respect to a given tax year unless exercised at or before the time for payment of tax under this section for such year, and such election once made shall be binding with respect to such grantor and such asset for all subsequent years;

(I) in the case of a trust grantor previously taxed on a trust asset under this Act, other than a grantor who has made an election with respect to such asset under subparagraph H above, where a trust beneficiary is later subject to throwback tax based on a deemed increment to worldwide wealth for the same such asset in the same such year, the grantor may request a refund of tax paid on such asset in such year, where the earliest time such refund may be requested is the year in which the beneficiary’s tax is paid and the latest such time shall extend from that year for such period of time as is permitted for the filing of amended returns under this Act; and such refund amount shall include payment of reasonable interest, as the Franchise Tax Board shall determine, but not at a rate to exceed the Estimated Economy-wide Normal Rate of Return;

(J) To the extent required by the United States Constitution and the Constitution of California, there shall be credited against the current-year or throwback tax liability of any grantor, beneficiary, or trust the amount paid to any taxing jurisdiction other than the State of California as an annual wealth tax on the assets taxable to such grantor, beneficiary, or trust under this subparagraph (5) for the same such time period; and

(K) There shall be no tax due on assets held by any trust recognized as a charitable trust under California law, or by any other organization exempt from federal income taxation under Title 26, Section 501 of
the U.S. Code; except that assets held by organizations claiming exemption from federal income taxation under Title 26, Section 501(c)(4) of the U.S. Code shall not be exempt if otherwise taxable under this subparagraph (5);

(6) Debts and other liabilities owed by the taxpayer shall be deductible against the taxpayer’s worldwide net worth for purposes of calculating the taxpayer’s annual wealth tax base, but only if such debts or liabilities are bonafide and only subject to the following limitations:

(A) Except as otherwise provided in subparagraphs 6(C) and (D), recourse debts for which the taxpayer is fully personally liable, without any limitations other than those arising from bankruptcy law, shall be fully deductible against the taxpayer’s worldwide net worth.

(B) Except as otherwise provided in this subparagraph and subparagraphs 6(C) and (D), non-recourse debts and other liabilities for which the taxpayer is not fully personally liable without any limitations other than those arising from bankruptcy law shall be fully deductible against the taxpayer’s worldwide net worth. The taxpayer must separately report the value of all assets serving as collateral for each such debt or liability. For each such debt or liability, the amounts deductible against net worth in any tax year on account of any such debt or liability, for purposes of calculating the taxpayer’s worldwide net worth, shall not exceed the amounts included in the taxpayer’s worldwide net worth in that tax year on account of the assets serving as collateral for the debt or liability; and the amount of each such debt or liability shall be reduced by the fair market value of any assets owned by another and also used to secure such debt or liability.

(C) No debt or liability described in subparagraphs 6(A) or 6(B) shall be deductible if such debt or liability is owed to a related person or persons, is contingent on future events that are uncertain to occur or that are uncertain to occur within the subsequent two years, or was not negotiated for at arm’s length. Additionally, no amounts shall be deductible for any such debt or liability unless market rates of interest are being charged to the taxpayer. Further, no deduction shall be allowed for any debt or liability for which payment of the liability itself or the interest thereon (or similar periodic payment charged in connection with the debt or
liability) is contingent on future events that are uncertain to occur or that are uncertain to occur within the subsequent two years.

(D) For any debt or liability of a taxpayer for which a taxpayer is entitled to receive future benefits or future ownership rights (for example, a contractual obligation to contribute to an entity at a future date), deductions shall be allowed only to the extent that either the value of those future benefits or ownership rights is included in the taxpayer’s wealth tax base or to the extent that the taxpayer can demonstrate that the amount owed under the debt or liability is in excess of any any future benefits or ownership rights that are not included in the taxpayer’s wealth tax base.

(E) For avoidance of doubt, no deductions shall be allowed for any debts or liabilities of the taxpayer except as specified in (A) through (D) of this subdivision.

(7) For all other assets—with the exceptions of real property directly held by the taxpayer and of rights to receive reasonable compensation for future work or for future services to be performed by the taxpayer—including but not limited to art and collectibles, nonpublicly traded financial instruments, intellectual property rights, debts and other liabilities owed to the taxpayer, and vehicles and other personal property, the taxpayer may exclude up to a total of a million dollars of value from the taxpayer’s worldwide net worth, summed across all such assets, for both annual reporting requirement purposes and for purposes of calculating the taxpayer’s annual wealth tax base. To the extent that the value of such assets collectively exceeds one million dollars, the taxpayer must report such excess and include such excess in the taxpayer’s worldwide net worth for purposes of calculating the taxpayer’s annual wealth tax base. For any such assets that were purchased or produced through an arm’s length transaction that was completed within the prior ten years, the valuation of such assets shall be deemed to be the valuation derived from such arm’s length transaction and then adjusted by the annual published Estimated Economy-wide Normal Rates of Return for each year or partial year since the transaction took place, after also making any proper adjustments for withdrawals, contributions, improvements, or depreciation of the assets. For any such assets that were not purchased or produced through an arm’s length transaction completed within the prior ten years, the
taxpayer must either submit a certified appraisal of the collective value of all such assets or else declare that the collective value of all such assets is less than one million dollars.

(8) Rules governing certified appraisals:

(A) For purposes of this Part, in any instance wherein a taxpayer is required to report or submit a certified appraisal, if the taxpayer has previously submitted, within the prior ten years, a certified appraisal for an asset or for a set of assets or for the taxpayer’s interests in an entity, and if the taxpayer declares that the taxpayer has not entered into any transactions since that prior certified appraisal that would substantially alter either the valuation or the percentage of the asset or assets or entity owned by the taxpayer, then the taxpayer may choose either (i) to submit a new certified appraisal for the value and the percentage owned by the taxpayer on December 31 of the tax year or (ii) to instead submit the prior certified appraisal with all valuations adjusted by the annual published Estimated Economy-wide Normal Rates of Return for each year or partial year since the prior certified appraisal, after also making any proper adjustments for withdrawals, contributions, improvements, or depreciation with respect to the relevant asset or assets or entity.

(B) Any appraiser making a certified appraisal for the purposes of this Part must send a copy of that certified appraisal to the Franchise Tax Board, along with also providing information sufficient for identifying the taxpayer for whom the certified appraisal was prepared, as well as also following any regulations or other relevant instructions adopted by the Franchise Tax Board.

(C) For purposes of making any certified appraisal for this Part, the appraiser must include within the contents of the appraisal a signed declaration as to whether the appraiser has “high”, “medium”, or “low” confidence that the amount determined to be the correct value of the appraised assets or property will not exceed 150 percent of the amount reported as the value of such assets or property in the certified appraisal.

(D) For any certified appraisal for which the appraiser declares “high” confidence that the amount determined to be the correct value of the appraised assets or property will not exceed 150 percent of the amount reported as the value of such assets or property in the certified appraisal, if it is subsequently determined
that the correct value of the appraised assets or property does exceed 150 percent of the amount reported as the value of such assets or property in the certified appraisal, then the appraiser shall be subject to the False Certified Appraisal penalty (as specified in subdivision (E)) in addition to any other applicable penalties.

(E) The False Certified Appraisal Penalty: the amount of the penalty imposed under subdivision (D) on any person with respect to a certified appraisal shall be equal to ten thousand dollars plus 125 percent of the sum of all payments for applicable appraisal services received from the taxpayer for whom the certified appraisal was made.

(F) For purposes of this Part, in any year in which a taxpayer is required to report or submit a certified appraisal under any provision of this Part, if the taxpayer reports or submits one or more certified appraisal for which the appraiser has declared only either “medium” or “low” confidence (as specified in subdivision (C)), then the taxpayer must choose to either (i) initiate an OUTCA to be attached to all of the taxpayer’s assets for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence (as specified in subdivision (b) of Section 50310 of this Part), or (ii) file with the Franchise Tax Board to begin the process of obtaining an Authorized Independent Appraisal for all of the taxpayer’s assets for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence (as specified in subdivision (b)(9) of this Section).

(G) The Franchise Tax Board shall adopt regulations further detailing the requirements for certified appraisals and for appraisers qualified to make certified appraisals for purposes of this Part, based on the qualified appraisal and qualified appraiser rules of Treasury Regulation 1.170A-17.

(9) Rules governing authorized independent appraisals:

(A) The Franchise Tax Board shall solicit and enter into contracts with a number of different independent appraisers whereby such appraisers will be authorized to be selected by the Franchise Tax Board to conduct authorized independent appraisals. The Franchise Tax Board will review the fees to be charged by such
appraisers for such authorized independent appraisals to ensure that such fees are reasonable based on market rates.

(B) Upon any taxpayer filing with the Franchise Tax Board to begin the process of obtaining an Authorized Independent Appraisal, the Franchise Tax Board shall present the taxpayer with two different options for independent appraisers who may be selected to conduct the authorized independent appraisal along with the schedule of fees to be charged by the independent appraisers if so selected. At that time, the Franchise Tax Board shall grant the taxpayer a reasonable time to either choose to designate one of these two options for independent appraisers to conduct the taxpayer’s authorized independent appraisal or else to opt to forgo the authorized independent appraisal and to instead initiate an OUTCA to be attached to all of the taxpayer’s assets for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence (as specified in subdivision (b) of Section 50310 of this Part). If the taxpayer chooses to designate either of the two options for independent appraisers to conduct the taxpayer’s authorized independent appraisal, then the taxpayer shall be responsible for paying all fees to be charged by that independent appraiser with respect to conducting the taxpayer’s authorized independent appraisal.

(C) Upon the completion of an authorized independent appraisal, the appraiser shall submit copies of the authorized independent appraisal to both the taxpayer and to the Franchise Tax Board. The taxpayer must then choose either to report to the Franchise Tax Board that the taxpayer will use the valuations obtained from the authorized independent appraisal in place of the valuations obtained from any prior certified appraisals with respect to all relevant assets or else the taxpayer may choose to instead forgo using any valuations obtained from the authorized independent appraisal but with the taxpayer instead choosing to initiate an OUTCA to be attached to all of the taxpayer’s assets for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence (as specified in subdivision (b) of Section 50310 of this Part). For avoidance of doubt, regardless of whether or not a taxpayer chooses to report to the Franchise Tax Board that the taxpayer will use the valuations obtained from an authorized independent appraisal, the taxpayer
shall be responsible for paying all fees to be charged by an independent appraiser designated by the taxpayer with respect to conducting that taxpayer’s authorized independent appraisal.

(D) For avoidance of doubt, both in soliciting and entering into contracts with independent appraisers and in selecting independent appraisers to be presented to taxpayers as one of the two options that may be designated by the taxpayer to conduct the taxpayer’s authorized independent appraisal, the Franchise Tax Board shall primarily seek to promote accuracy in the authorized independent appraisals. In so seeking to promote accuracy, the Franchise Tax Board shall primarily prioritize the selection of independent appraisers who have a demonstrated history of conducting accurate authorized independent appraisals and shall secondarily prioritize the selection of independent appraisers who have the best capacity and expressed commitment for conducting accurate authorized independent appraisals.

(E) The Franchise Tax Board shall adopt regulations further detailing the requirements for authorized independent appraisals and for selecting appraisers for conducting such appraisals.

(10) If, pursuant to the provisions of either (b)(8) or (b)(9) of this Section, a taxpayer chooses to initiate an OUTCA to be attached to all of the taxpayer’s assets for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence, and if some or all of those assets previously had either an OUTCA or a LOUTCA attached to them, then that prior OUTCA or LOUTCA shall not be fully reconciled or closed and instead shall continue to apply to any and all assets for which both the OUTCA or LOUTCA was previously attached and for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence, and then with a new OUTCA to be initiated and attached to any other assets for which the taxpayer submitted certified appraisals wherein the appraiser declared only “medium” or “low” confidence and for which no OUTCA or LOUTCA was previously attached.

(c) The Franchise Tax Board shall adopt regulations for all of the following:

(1) The Franchise Tax Board shall adopt regulations detailing abusive transactions whose aim is to change the nature of an asset
from public to nonpublic or vice versa.

(2) The Franchise Tax Board shall adopt regulations detailing abusive transactions whose aim is to artificially reduce the assessed value of a taxpayer’s assets. Any feature of an asset intended to, and having the effect of, decreasing the value of the asset, such as a “poison pill,” shall be disregarded. Additionally, no valuation discount, or any other discount, shall apply if the effect of the discount would be to reduce the value of a pro rata economic interest in an asset below the pro rata value of the entire asset.

50309. The Franchise Tax Board shall adopt regulations on the following subjects to require information reporting.

(a) (1) All nonpublicly traded business entities other than sole proprietorships that are doing business in this state, organized in this state, or registered with the Secretary of State shall file an annual information return specifying all of the following:

(A) the information required to calculate the value of the business required by 50308(b) on forms and instructions prescribed by the Franchise Tax Board and

(B) the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income of the entity if distributed and the amount of the distributive share of each person.

(C) The information return shall contain or be verified by a written declaration that it is made under penalty of perjury, signed by one of the partnership members or corporate officers.

(D) The Franchise Tax Board shall request the information described under subsections (A), (B) and (C) from a business entity not required to submit the information return but subject to jurisdiction of the state of California under Code of Civil Procedure 410.10 if the Franchise Tax Board reasonably believes that that entity contributes substantial wealth to a taxpayer subject to the wealth tax.

(2) (1) All trusts required to file income tax returns in California shall file an annual information return specifying all of the following:

(A) the information required to calculate the value of the assets in the trust listed in Section 50308(b) on forms and instructions prescribed by the Franchise Tax Board and
(B) the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income or assets of the trust if distributed and the amount of the distributive share of each person.

(C) The information return shall contain or be verified by a written declaration that it is made under penalty of perjury, signed by one of the partnership members or corporate officers.

(D) The Franchise Tax Board shall request the information described under subsections (A), (B) and (C) from a trust not required to submit the information return but subject to jurisdiction of the state of California under Code of Civil Procedure 410.10 if the Franchise Tax Board reasonably believes that that trust contributes substantial wealth to a taxpayer subject to the wealth tax.

(b) Each business entity or trust required to file an information return under subdivision (a) shall, on or before the day on which the return for that taxable year was required to be filed, furnish to each person who holds an interest in that entity at any time during that taxable year a copy of that information required to be provided in subsection (a)(1).

(c) Any taxpayer that submits a certified appraisal shall file an agreement in the form required by the Franchise Tax Board to:

1) acknowledge that the appraisal is being accepted as proof of value because of uncertainty as to contingent events or lack of reasonable access to information and therefore the taxpayer agrees to file for the following four years:

2) annual information returns concerning A) whether or not any of the transactions permitting retrospective formulaic alternative valuation under Section 50308(b)(3)((E) have occurred or B) any other material information is now available permitting substantially more accurate valuation

3) any information reported as available in subsection 2 shall be reported on forms and instructions prescribed by the Franchise Tax Board.

4) The Franchise Tax Board shall mail a notice of a proposed deficiency assessment to a taxpayer within five years after the agreement described in subsection (c)(1) was filed.

50310. Optional Unliquidated Tax Claim Agreements

(a) Liquidity-based Optional Unliquidated Tax Claim Agreements, to be referred to as LOUTCAs, shall be governed by the following rules:
(1) Taxpayers who are specified as liquidity-constrained taxpayers and who have ownership interests in designated highly-illiquid assets, such as in startup business entities, shall be able to elect to initiate a LOUTCA to be attached to their ownership interests in those designated highly-illiquid assets instead of the net value of those ownership interests or the net value of those assets being assessed at the end of a tax year.

(2) The Legislature presumes that any taxpayer subject to the Wealth Tax is not specified as a liquidity-constrained taxpayer if the taxpayer’s designated highly-illiquid assets are less than 80 percent of the taxpayer’s total net worth. The Franchise Tax Board shall adopt regulations in regard to substantiating who is or is not a specified liquidity-constrained taxpayer and in regard to what is and what is not a designated highly-illiquid asset. For the removal of doubt, the Legislature finds that most taxpayers subject to the Wealth Tax should not be specified as liquidity-constrained taxpayers and that neither any publicly traded assets nor any ownership interests conferring control rights in substantially profitable privately held business entities shall be designated as highly-illiquid assets.

(3) In order to initiate any LOUTCA, a taxpayer must sign forms to be created by the Franchise Tax Board that shall have the effect of creating a binding contractual agreement between the taxpayer and the state. As part of such contract, the taxpayer shall agree to: (i) file annual information returns described in subsection 4, (ii) reconcile and pay all tax liabilities arising under the LOUTCA, and (iii) to be subject to personal jurisdiction in this state for purposes of the collection of wealth taxes, together with any related interest or penalties, imposed on the taxpayer by this state, with respect to the LOUTCA. Such contracts shall be legally binding on the taxpayer, and also on the taxpayer’s estate and assigns, until such time as either the taxpayer or the taxpayer’s estate reconciles the LOUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax due on such liquidated tax claims.

(4) If a taxpayer has initiated a LOUTCA in any prior year, until such LOUTCA has been reconciled and closed, the taxpayer must annually complete and file any form or forms that shall be created by the Franchise Tax Board for the purposes of reporting any material transactions made with regard to the LOUTCA. The taxpayer must continue to annually file such forms until the taxpayer has reconciled the LOUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims. As a component of the legal contract signed by the
taxpayer upon initiating a LOUTCA, such reporting requirements shall continue even if and after the taxpayer is no longer a resident of California and shall then be enforced as a legally binding contract with the state. Failure to file such annual forms shall be treated as a breach of contract and shall also be subject to the same penalties as failure to file income tax forms for California residents who are required to file income tax forms. Upon the death of any taxpayer who has initiated a LOUTCA that has not been fully reconciled and closed, that taxpayer’s estate and assigns shall be required to reconcile the LOUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims, treating these claims as an unpaid tax liability of the taxpayer owed to the state.

(5) If, in any year, a taxpayer who has previously initiated a LOUTCA no longer qualifies as a liquidity-constrained taxpayer, then that taxpayer must reconcile any and all LOUTCAs in that year so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims, thereby closing the OUTCA for subsequent years.

(6) In any year, a taxpayer who has previously initiated a LOUTCA may opt to reconcile the LOUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims, thereby closing the OUTCA for subsequent years.

(7) For the year in which a taxpayer initiates a LOUTCA and also in every subsequent year until after the LOUTCA has been fully reconciled and closed, the taxpayer must file the forms to be created by the Franchise Tax Board for purposes of calculating the taxpayer’s Accumulated Unliquidated Tax Liability Percentage with respect to the LOUTCA. For the initial year in which a taxpayer initiates a LOUTCA, the taxpayer’s Accumulated Unliquidated Tax Liability Percentage shall equal the taxpayer’s highest marginal wealth tax rate for that year. (For example, if the taxpayer’s highest marginal wealth tax rate for that year is 0.4 percent, then the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the initial year would be 0.4%). For each subsequent year after a taxpayer has initiated a LOUTCA and prior to that LOUTCA having been closed, the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the year shall equal the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the prior year plus the product of [the taxpayer’s highest marginal wealth tax rate for the year] and [one hundred percent minus the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the prior year.] (For example, in the second year
after a taxpayer has initiated a LOUTCA, if the taxpayer’s highest marginal wealth tax rates for both years is 0.4 percent, then the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for that second year would be 0.7984 percent, which is 0.4 percent plus the product of 0.4 percent and 99.6 percent).

(9) To reconcile a LOUTCA so as to fully liquidate the accumulated tax claims and to then close the LOUTCA, a taxpayer must report the current-tax-year value of all of the taxpayer’s ownership interests in all of the assets to which the LOUTCA is attached (following all of the rules and requirements Section 50308 of this Part). The taxpayer must then multiply the total of these reported values by the taxpayer’s Accumulated Unliquidated Tax Liability Percentage with respect to the LOUTCA. The taxpayer must then add this product to the taxpayer’s other wealth tax liability for the tax year and then must pay that wealth tax in order to close the LOUTCA.

(10) If, prior to closing a LOUTCA, a taxpayer withdraws any money, property, or other value from any assets to which a LOUTCA is attached or from being attached to a LOUTCA, or if any assets to which a LOUTCA is attached are used in any transactions that have the effect of either transferring any assets or value from being attached to the LOUTCA to the taxpayer without such attachments or to a related person or of using any such assets or value for the benefit of the taxpayer or of a related person—with the exceptions of ordinary and necessary transactions for maintaining or increasing the value of assets to which a LOUTCA is attached and that would not have the effect of distributing any profits, dividends, or other payments to owners for the use of capital, or similar such transfers—then such withdrawals or transactions shall be deemed to be material transactions that the taxpayer must report annually on forms to be created by the Franchise Tax Board. For any such reported material transactions, the taxpayer must report the value withdrawn from being attached to the LOUTCA or transferred or used for the benefit of the taxpayer or of a related person. The taxpayer must then multiply the taxpayer’s Accumulated Unliquidated Tax Liability Percentage with respect to the LOUTCA by the reported value of all such material transactions for the tax year and must then add this product to the taxpayer’s other wealth tax liability for the tax year.

(b) Optional Unliquidated Tax Claim Agreements that are not liquidity based, to be referred to as OUTCAs, shall be governed by the following rules:
In order to initiate any OUTCA, a taxpayer must sign forms to be created by the Franchise Tax Board that shall have the effect of creating a binding contractual agreement between the taxpayer and the state. As part of such contract, the taxpayer shall agree to: (i) file annual information returns described in subsection 2, (ii) reconcile and pay all tax liabilities arising under the OUTCA, and (iii) to be subject to personal jurisdiction in this state for purposes of the collection of wealth taxes, together with any related interest or penalties, imposed on the taxpayer by this state, with respect to the OUTCA. Such contracts shall be legally binding on the taxpayer, and also on the taxpayer’s estate and assigns, until such time as either the taxpayer or the taxpayer’s estate reconciles the OUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax due on such liquidated tax claims.

If a taxpayer has initiated an OUTCA in any prior year, until such OUTCA has been reconciled and closed, the taxpayer must annually complete and file any form or forms that shall be created by the Franchise Tax Board for the purposes of reporting any material transactions made with regard to the OUTCA. The taxpayer must continue to annually file such forms until the taxpayer has reconciled the OUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims. As a component of the legal contract signed by the taxpayer upon initiating an OUTCA, such reporting requirements shall continue even if and after the taxpayer is no longer a resident of California and shall then be enforced as a legally binding contract with the state. Failure to file such annual forms shall be treated as a breach of contract and shall also be subject to the same penalties as failure to file income tax forms for California residents who are required to file income tax forms. Upon the death of any taxpayer who has initiated an OUTCA that has not been fully reconciled and closed, that taxpayer’s estate and assigns shall be required to reconcile the OUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims, treating these claims as an unpaid tax liability of the taxpayer owed to the state.

For the year in which a taxpayer initiates an OUTCA and also in every subsequent year until after the OUTCA has been fully reconciled and closed, the taxpayer must file the forms to be created by the Franchise Tax Board for purposes of calculating the taxpayer’s Accumulated Unliquidated Tax Liability Percentage with respect to the OUTCA. For the initial year in which a taxpayer initiates an OUTCA, the taxpayer’s...
Accumulated Unliquidated Tax Liability Percentage shall equal the taxpayer’s highest marginal wealth tax rate for that year. (For example, if the taxpayer’s highest marginal wealth tax rate for that year is 0.4 percent, then the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the initial year would be 0.4%). For each subsequent year after a taxpayer has initiated an OUTCA and prior to that OUTCA having been closed, the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the year shall equal the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the prior year plus the product of [the taxpayer’s highest marginal wealth tax rate for the year] and [one hundred percent minus the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for the prior year.] (For example, in the second year after a taxpayer has initiated an OUTCA, if the taxpayer’s highest marginal wealth tax rates for both years is 0.4 percent, then the the taxpayer’s Accumulated Unliquidated Tax Liability Percentage for that second year would be 0.7984 percent, which is 0.4 percent plus the product of 0.4 percent and 99.6 percent).

(4) For the year in which a taxpayer initiates an OUTCA and also in every subsequent year until after the OUTCA has been fully reconciled and closed, the taxpayer must file the forms to be created by the Franchise Tax Board for purposes of calculating the Accumulated Prior Wealth Tax Payments made with respect to the OUTCA and assets to which the OUTCA is attached. Such calculation shall assess and track the sum of all prior wealth tax paid by the taxpayer on account of owning assets to which an OUTCA is attached, beginning in the later of either the year of the initiation of the OUTCA or the year in which the OUTCA was attached to such assets and continuing throughout all subsequent years until after the OUTCA has been fully reconciled and closed.

(5) If, prior to closing an OUTCA, a taxpayer withdraws any money, property, or other value from any assets to which an OUTCA is attached, or if any assets to which an OUTCA is attached are used in any transactions that have the effect of either transferring any assets or value from being attached to the OUTCA to the taxpayer without such attachments or to a related person or of using any such assets or value for the benefit of the taxpayer or of a related person--with the exceptions of ordinary and necessary transactions for maintaining or increasing the value of assets to which an OUTCA is attached and that would not have the effect of distributing any profits, dividends, or other payments to owners for the use of capital, or similar such transfers--then such
withdrawals or transactions shall be deemed to be material transactions that the taxpayer must report annually on forms to be created by the Franchise Tax Board. For any such reported material transactions, the taxpayer must report the value withdrawn from the assets to which the OUTCA is attached or otherwise transferred or used for the benefit of the taxpayer or of a related person. The taxpayer must then multiply the taxpayer’s Accumulated Unliquidated Tax Liability Percentage with respect to the OUTCA by the reported value of all such material transactions for the tax year. This product shall then be subtracted from the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA. To the extent that this subtraction would reduce the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA to below zero, the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA shall not be reduced to below zero, and instead the taxpayer must add the amount by which the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA would otherwise be reduced to below zero to the taxpayer’s other wealth tax liability to be reported and paid for the tax year.

(6) If and when a taxpayer reconciles an OUTCA so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims, so as to close the OUTCA--whether such reconciliation be mandated or else allowed by a provision making such reconciliation optional in the tax year--the taxpayer must submit a certified appraisal (following and subject to all of the rules governing certified appraisals and authorized independent appraisals of Section 50308 of this Part) of all of the assets to which the OUTCA was attached immediately prior to such reconciliation. The taxpayer must then multiply the taxpayer’s Accumulated Unliquidated Tax Liability Percentage with respect to the OUTCA by total value reported based on that certified appraisal for all of the assets to which the OUTCA was attached prior to such reconciliation. This product shall then be subtracted from the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA. To the extent that this subtraction would reduce the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA to below zero, the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to the OUTCA shall not be reduced to below zero, and instead the taxpayer must add the amount by which the taxpayer’s Accumulated Prior Wealth Tax Payments made with respect to
the OUTCA would otherwise be reduced to below zero to the taxpayer’s other wealth tax liability to be reported and paid for the tax year. Following the payment of any and all wealth tax owed as a result of this, the OUTCA shall be deemed to be closed for all subsequent years. 

(7) If, in any year, a taxpayer who has previously initiated an OUTCA sells, disposes of, or otherwise terminates all of the taxpayer’s interests in the OUTCA and in all assets to which the OUTCA is attached, then after paying any wealth tax owed as a result of any such transactions that are material transactions, the OUTCA shall be deemed fully liquidated and closed.

(8) If, in any two subsequent years, a taxpayer who has previously initiated an OUTCA ceases to owe any wealth tax to the state, such as either because the taxpayer’s worldwide net worth is less than the relevant exemption threshold of 50305(a)(1) or because the taxpayer ceases to be a wealth tax resident (as defined in 50313(a)(4)), then the taxpayer may opt to reconcile any or all OUTCAs in that second year so as to fully liquidate the accumulated tax claims and to then pay all tax owed on such liquidated tax claims so as to then close the OUTCA or OUTCAs.

(c) As used in both subdivisions (a) and (b) of this Section, the term “taxpayer” shall also include any estate or assigns of a taxpayer made liable under this provision for satisfaction of such taxpayer’s LOUTCA or OUTCA.

50311. (a) The value of all assets subject to the Wealth Tax shall be reported annually, but any amount of net-worth wealth tax on those assets paid to another jurisdiction shall be credited against the Wealth Tax. Any credits created by this section, however, shall not exceed the total tax owed under the Wealth Tax. For the avoidance of doubt, this section shall only provide a credit for a tax on net worth, or a tax on real property as described in subdivision (b), and no credit shall be created by any other tax, including but not limited to a tax whose amount is determined by reference to the occurrence or amount of any transactions, income, capital gains, death, or inheritance, whatever the economic incidence of such tax.

(b) Notwithstanding subdivision (a), a taxpayer who owns real property indirectly, as through a corporation, partnership, limited liability company, trust, or other such legal form, shall receive a credit for their pro rata share of any property taxes paid on the gross or net value of real property to any jurisdiction. This credit
is limited to taxes paid with regard to ownership of the real property, and no credit shall be created by any transactions tax, excise tax, or any other tax based on use of the property. The credit created by this subdivision for each separate unit of real property shall not exceed the portion of the taxpayer’s total Wealth Tax liability attributable to the taxpayer’s ownership interest in the real property.

(c) To claim the credits described in subdivision (b), a taxpayer must separately report each of the following items:

1. The fair market value of each unit of real property.
2. The assessed value used to calculate any creditable property taxes imposed on each unit of real property.
3. The property taxes paid, for which credit is being claimed.
4. All mortgages and other liabilities secured by or used for the purpose of each unit of real property.

50312. Notwithstanding the provisions of Section 50306, the value of directly held real or personal property excluded from calculation of a taxpayer’s worldwide net worth shall be reported on the taxpayer’s annual return, along with any liabilities secured by or used for the benefit of directly held real property. Liabilities secured by or used for the benefit of directly held real property shall not be considered in determining worldwide net worth of a taxpayer. The Franchise Tax Board shall adopt regulations for apportioning taxpayer’s overall liabilities to exclude liabilities related to directly held real property. These regulations shall provide that, at a minimum, a percentage of each taxpayer’s overall liabilities, equal to the percentage the taxpayer’s directly held real property interest bears to all of the taxpayer’s worldwide assets, shall be excluded from the calculation of the taxpayer’s worldwide net worth.

50313. (a) (1) For purposes of this part, a taxpayer is considered a resident of California for a given year, if such taxpayer is a California resident for purposes of the California income tax as determined by Section 17014.

(2) Part-Year Resident. A part-year resident is determined as by Section 17015.5. Part-year residents shall be taxed on their
worldwide net worth according to this part, but for purposes of calculating such tax, the taxpayer’s worldwide net worth shall be multiplied by the percentage of days in the year such taxpayer was present in this state.

(3) Temporary Resident. A taxpayer who spends more than 60 days in California and 1) the taxpayer has cumulatively spent at least 120 days in California over the last two years and/or 2) the taxpayer has cumulatively spent at least 150 days in California over the last four years, but who does not qualify as a resident under Section 17014 or part-year resident under 17015.5, shall be treated as a temporary resident in the first year that the two conditions above are satisfied. Temporary residents shall be taxed on their worldwide net worth according to this part, but for purposes of calculating that tax, the taxpayer’s worldwide net worth shall be multiplied by the percentage of days in the year the taxpayer was present in this state.

(4) Wealth Tax Resident. Any taxpayer with extreme wealth sourced to this state according to the rule of paragraph (3) of subdivision (b).

(b) Special Apportionment Rules for Wealth Tax.

(1) General Rule. In general, the portion of a taxpayer’s wealth subject to the tax imposed by this part shall be multiplied by a fraction, the numerator of which shall be years of residence in California over the 4 last years, and the denominator of which shall be 4. For the purpose of calculating the numerator described in the previous sentence, any partial year of residence as calculated under paragraphs (2) and (3) of subdivision (a) and shall be included in the numerator.

(2) Special Rule for New Residents. For new residents of California who have never been a California resident before in any prior year, the calculation of the numerator under paragraph (1) of subdivision (b) shall be 0. For such new residents in their second year of residence in California, the numerator shall be 1, and the number 1 shall then be added for each subsequent year until the numerator reaches 4.

(3) Special Rule for Wealth Tax Residents.

(A) For taxpayers who were subject to the Wealth Tax in one of the preceding 4 years, and are no longer residents of this state as residence is defined in Section 50310, and do not have the reasonable expectation to return to this state, the calculation of the numerator under paragraph (1) shall be as follows. For the first year of nonresidence in California, a fraction between 0 and
1, as calculated under subdivision (b) of Section 50310, plus the years of residence in California over the three previous years shall be the numerator. For each subsequent year, the number 1 should be subtracted until the numerator reaches 0.

(B) For any taxpayer who pays tax under this part as a former resident, but then returns to California, the apportionment rule shall be the general rule of paragraph (1) of subdivision (b).

(4) Petition for Alternative Apportionment. If apportionment provisions of this part do not fairly represent the extent of the benefit granted to the taxpayer to accumulate extreme wealth in this state, then the taxpayer may petition for, or the tax administrator may require, in respect to all or any part of the taxpayer’s wealth, the use of an alternative apportionment method.

(A) Burden of Proof. In any proceeding for alternative apportionment, the burden shall be on the petitioning party to demonstrate by clear and convincing evidence that the standard method is unfair and that a more fair and reasonable method is available.

(B) (1) Authority to Adopt Regulations. In case of recurring fact patterns involving taxpayers, the Franchise Tax Board may, in addition to the authority provided in this part, adopt appropriate rules or regulations for determining alternative apportionment methods for those taxpayers.

(2) For the removal of doubt, the Legislature expects that most full-time post-secondary students will not have any wealth deemed as accumulated in California while students.

(c) For purposes of calculating who is a resident under this part, the taxpayer is only considered a resident when no longer a dependent of another taxpayer, as dependent is defined in Section 17056.

(d) In the event any provision of this section, including, but not limited to, paragraphs (2), (3), and (4) of subdivision (a), is found by a court to be invalid, unconstitutional, or otherwise unenforceable, that finding shall not affect the enforceability of any other provision of this section.

50314. Penalties and Enforcement Rules:

(a) A taxpayer subject to the tax imposed under this part with an understatement of tax for any taxable year shall be
subject to the penalty imposed under this section if that understatement exceeds the greater of the following:

(1) One million dollars ($1,000,000).
(2) Twenty percent of the tax shown on an original return or shown on an amended return filed on or before the original or extended due date of the return for the taxable year.

(b)(1) The penalty under this section shall be an amount equal to 20 percent of any understatement of tax. For purposes of this section, “understatement of tax” means the amount by which the tax imposed by this part exceeds the amount of tax shown on an original return or shown on an amended return filed on or before the original or extended due date of the return for the taxable year.

(2) The penalty under this section shall be an amount equal to 40 percent of any understatement of tax if that understatement was substantially the result of not reporting an asset required to be listed under Section 50303(c).

(c) The penalty imposed by this section shall be in addition to any other penalty imposed under Part 10.2 (commencing with Section 18401) or under any other applicable Section of this Part or other relevant provision of law.

(d) A refund or credit for any amounts paid to satisfy a penalty imposed under this section may be allowed only on the grounds that the amount of the penalty was not properly computed by the Franchise Tax Board.

(e) No penalty shall be imposed under this section on any understatement to the extent that the understatement is attributable to any of the following:

(1) A change in law that is enacted, adopted, issued, or becomes final after the earlier of either of the following dates:
    (A) The date the taxpayer files the return for the taxable year for which the change is operative.
    (B) The extended due date for the return of the taxpayer for the taxable year for which the change is operative.

(2) For purposes of this subdivision, a “change of law” means a statutory change or an interpretation of law or rule of law by regulation, legal ruling of counsel, within the meaning of subdivision (b) of Section 11340.9 of the Government Code, or a published federal or California court decision.

(3) The Franchise Tax Board shall implement this subdivision in a reasonable manner.
(f) No penalty shall be imposed under this section to the extent that a taxpayer’s understatement is attributable to the taxpayer’s reasonable reliance on written advice of the Franchise Tax Board, but only if the written advice was a legal ruling by the chief counsel, within the meaning of paragraph (1) of subdivision (a) of Section 21012.

(g) Notwithstanding any other provisions of law, the Franchise Tax Board is authorized to hire and pay reasonable fees to any outside experts or outside counsel as may be appropriate and helpful for vigorously enforcing this Part.

50315. Application of the False Claims Act.
   (a) Notwithstanding Section 12651(f) of the Government Code or any other law, Sections 12650 through 12656 of the Government Code shall apply to claims, records, and statements made under or pursuant to this Part, but only if the damages pleaded under such action exceed two hundred thousand dollars.
   (b) The Attorney General or prosecuting authority shall consult with the taxing authorities to whom the claim, record, or statement was submitted prior to filing or intervening in any action authorized by this section.
   (c) Notwithstanding any other law, the Attorney General or prosecuting authority, but not the qui tam plaintiff, is hereby authorized to obtain otherwise confidential records relating to taxes, fees, surcharges, or other obligations under the Revenue and Taxation Code needed to investigate or prosecute suspected violations of this subdivision from state and local taxing and other governmental authorities in possession of such information and records, and such authorities are hereby authorized to make those disclosures. The taxing and other governmental authorities shall not provide federal tax information without authorization from the Internal Revenue Service.
   (d) Any information received pursuant to paragraphs (b) and (c) shall be kept confidential except as necessary to investigate and prosecute suspected violations of this subdivision.
   (e) This section does not apply to claims, records, or statements for the assets of a person that have been transferred to the Commissioner of Insurance, pursuant to Section 1011 of the Insurance Code.
   (f) Section 12651 of the Government Code is amended by adding a new subdivision (h) to read as follows:
      (h) Notwithstanding subdivision (f), this section shall apply to claims, records, and statements made under Part 27 of the Revenue and Taxation
Code (the Wealth Tax Act), but only if the damages pleaded under such action exceed two hundred thousand dollars.

(1) With regard to any action authorized by subdivision (h), any person who:

(A) makes, uses, or causes to be made or used, a false record or statement material to their own obligation to pay money to the state or a local government under the tax law, or an obligation of a subsidiary, partnership, corporation, or entity that they control; or

(B) conceals or improperly avoids or decreases their own obligation to pay money to the state or a local government under the tax law, or an obligation of a subsidiary, partnership, corporation or entity that they control; shall be liable for damages, including consequential damages, which the state or local government sustains because of the act of that person. For purposes of this subdivision, consequential damages includes interest owed pursuant to the tax law.

(C) For avoidance of doubt and solely for purposes of subdivision (h), the person shall be liable for the damages specified in subdivision (h)(1)(B) regardless of whether or not the person acted knowingly.

(D) For avoidance of doubt, any person who commits any of the acts enumerated in subdivision (a) with respect to claims, records, or statements made under Part 27 of the Revenue and Taxation Code (the Wealth Tax Act), shall be liable for the damages specified in subdivision (a), but only if the damages pleaded under such action exceed two hundred thousand dollars and only to the extent that the damages specified in subdivision (a) are in excess of or otherwise not duplicative of the damages specified in subdivision (h)(1)(B).

(2) For purposes of subdivision (h), “person” shall have the meaning ascribed to it in Section 17007 of the Revenue and Taxation Code.
(3) The Attorney General or prosecuting authority shall consult with the taxing authorities to whom the claim, record, or statement was submitted prior to filing or intervening in any action under this article that is based on the filing of false claims, records, or statements made under the Revenue and Taxation Code.

(4) Notwithstanding any other law, the Attorney General or prosecuting authority, but not the qui tam plaintiff, is hereby authorized to obtain otherwise confidential records relating to taxes, fees, surcharges, or other obligations under the Revenue and Taxation Code needed to investigate or prosecute suspected violations of this subdivision from state and local taxing and other governmental authorities in possession of such information and records, and such authorities are hereby authorized to make those disclosures. The taxing and other governmental authorities shall not provide federal tax information without authorization from the Internal Revenue Service.

(5) Any information received pursuant to paragraphs (3) and (4) shall be kept confidential except as necessary to investigate and prosecute suspected violations of this subdivision.

(6) With regard to any demand for payment or request for payment based on an alleged violation of Section 12651 that is based in whole or in part on any claims, records, or statements made under Part 27 of the Revenue and Taxation Code (the Wealth Tax Act), if such demand or request is made prior to the filing of a complaint under Section 12652(b)(2) and is made by an attorney representing a private person, then such shall be deemed a violation of the requirement that the complaint be filed in superior court in camera.

(g) Section 12652 of the Government Code is amended by adding new subdivisions (k) and (l) to read as follows:

(k) With respect to any action brought by a qui tam plaintiff under subdivision (c) of this section that is authorized by subdivision (h) of section 12651 (relating to claims, records, or statements made under the Wealth Tax Act), the Attorney General shall fully investigate all such alleged violations to determine their merit. For any such action that the
Attorney General determines to potentially have merit, the Attorney General shall elect to intervene and proceed with the action unless either another prosecuting authority intends to proceed with the action or the Attorney General determines that there are strongly overriding reasons of law or of public policy to justify the Attorney General not intervening.

(1) If the Attorney General elects not to intervene in any such action in which no other prosecuting authority opts to intervene, the qui tax plaintiff may demand that the Attorney General explain in writing—but with any confidential taxpayer information and any other information or details that the Attorney General deems should be kept confidential or private to be omitted—either why the Attorney General has determined that the action does not potentially have merit or what strongly overriding reasons of law or of public policy the Attorney General has determined to justify the failure to intervene despite the action potentially having merit.

(2) If the Attorney General elects not to intervene in any such action and no other prosecuting authority opts to intervene, and if the qui tam plaintiff proceeds with the action, then any defendant at any time after being notified of the action may demand that the Attorney General explain in writing—but with any confidential taxpayer information and any other information or details that the Attorney General deems should be kept confidential or private to be omitted—either why the Attorney General has determined that the action does not potentially have merit or what strongly overriding reasons of law or of public policy the Attorney General has determined to justify the failure to intervene despite the action potentially having merit.

(3) If either a qui tam plaintiff or any defendant so demand that the attorney general explain a decision not to intervene in any such action in writing, then the Attorney General shall publish such explanation so as to make it publicly available, but only after first revising such explanation to the extent appropriate for the purposes of fully omitting any confidential taxpayer information and any other information or details that the Attorney General deems should be kept confidential or private.
(1) The Attorney General shall establish and publicize a set of procedures whereby any potential qui tam plaintiff under subdivision (c) of this section, who is considering bringing an action authorized by subdivision (h) of section 12651 (relating to claims, records, or statements made under the Wealth Tax Act), may submit an application for a preliminary investigation. As part of such preliminary investigation, the Attorney General shall obtain any records needed to determine whether the action being considered might have merit and shall then inform the potential qui tam plaintiff as to whether the action being considered might have merit.

(1) Examples of when such preliminary investigations are warranted include, but are not limited to, cases in which a potential qui tam plaintiff has information about wealth or the valuation of wealth that has not previously been publicly disclosed in a manner specified by subdivision (3)(A) of this section and that the potential qui tam plaintiff has reason to suspect may have been falsely or wrongfully omitted from or misstated on a claim, record, or statement made under the Wealth Tax Act, but with the qui tam plaintiff not knowing with certainty whether such information was actually omitted from or misstated on a claim, record, or statement made under the Wealth Tax Act. In such examples, unless the Attorney General determines that an application for a preliminary investigation is frivolous, the Attorney General shall obtain any records needed to determine whether the action being considered might have merit and shall then inform the potential qui tam plaintiff as to whether the action being considered might have merit.

(2) If a potential qui tam plaintiff submits an application for a preliminary investigation, this shall not in any way limit the potential qui tam plaintiff’s rights to subsequently proceed with bringing an action under subdivision (c) of this section. After a potential qui tam plaintiff has submitted an application for a preliminary investigation, the Attorney General shall not take any action that would limit the potential qui tam plaintiff’s rights to subsequently proceed with bringing an action under subdivision (c) of this section without first informing the potential qui tam plaintiff and then giving that potential qui tam plaintiff a reasonable
timeframe for bringing an action under subdivision (c) prior to the Attorney General taking any actions that might limit the potential qui tam plaintiff’s rights to do so.

(h) The Legislature finds and declares that the portions of this subdivision which amend Section 12651 of the Government Code imposes a limitation on the public’s right of access to the meetings of public bodies or the writings of public officials and agencies within the meaning of Section 3 of Article I of the California Constitution. Pursuant to that constitutional provision, the Legislature makes the following findings to demonstrate the interest protected by this limitation and the need for protecting that interest: In order to protect the existing confidentiality of tax records, it is necessary to limit the public’s access to these documents.

50316. Task Force on Wealth Tax Administration and Enforcement Funding.
(a) The Legislature shall establish a task force on wealth tax administration immediately after this section is enacted.
(b)(1) The purpose of the task force will be to assure adequate funding and staffing for the administration of the wealth tax, including at both the Franchise Tax Board and the Office of the Attorney General. Adequate funding should result in an audit rate for taxpayers with wealth of $1 billion or greater of 100%. Adequate funding should result in an audit rate for taxpayers with wealth between $100 million and $1 billion of at least 25%. Adequate funding should additionally make it both possible and feasible for the Franchise Tax Board to hire any outside experts or outside counsel as appropriate and helpful for vigorously enforcing this Part.
(2) For the first two years of operation, $50 million dollars or 1% of all projected revenues from the wealth tax, whichever is greater, shall be deposited in a special account at the Franchise Tax Board for the purpose of setting up the administration and enforcement of the wealth tax.
(3) For the first two years of operation, $25 million dollars or .5% of all projected revenues from the wealth tax, whichever is greater, shall be deposited into a special account at the Office of the Attorney General for the purpose of setting up the enforcement of the wealth tax.
(4) The Task Force shall recommend prudently spending down any excess funds in the accounts described in subsections (2) and (3).
(c) The task force shall propose an appropriate level of funding for wealth tax administration annually, with the first proposal due six months after this section is enacted.
(d) The Governor, the Treasurer, the Controller, the Legislature and the Executive Director of the Franchise Tax Board shall each appoint one member from each of the following three categories: (1) a current or retired California revenue official, (2) a taxpayer representative, (3) a policy analyst or academic.

(e) Appointment of task force members:

(1) All appointments shall be made within 40 days of the effective date of this act. In the event that any of the appointments are not completed within the permitted timeframe, the task force shall proceed to operate with the appointments that are in place, provided that at least 60 percent of the appointments have been made.

(2) Forty-five days after the effective date of this act, the Executive Director of the Franchise Tax Board shall convene a meeting of the appointed members of the task force to elect a chairperson and vice chairperson from among the individuals nominated by the constitutional officers pursuant to subdivision (d).

(3) The members shall serve eight-year terms. Members shall serve a maximum of two terms, unless earlier removed pursuant to paragraph (5).

(4) If a vacancy occurs within a term, the appointing authority shall appoint a replacement member within 90 days to serve the remainder of the term.

(5) When a term expires, the appointing authority shall appoint a member within 90 days. Task force members shall continue to serve until their replacements are appointed.

(6) Notwithstanding paragraph (3), the appointing authority may replace a member, other than the chairperson or vice chairperson, who has served, as of the effective date of the act adding this paragraph, at least half of the member’s current term, by appointing a new member, who shall be eligible to serve a full term. These appointments shall be made within 90 days of the effective date of the initiative adding this paragraph.

(7) The task force may, by a vote of 60 percent of a quorum, recommend the removal of a member by the member’s appointing authority, or in the case of the chairperson and the vice chairperson, the nominating authority or nominating authorities, if more than one constitutional officer nominated the chairperson or vice chairperson. The appointing authority or nominating authority or authorities in the case of the chairperson and vice chairperson, shall have the authority to remove the member, chairperson, or vice chairperson, respectively, upon receipt of
the task force’s recommendation. If more than one constitutional officer nominated the chairperson or vice chairperson, each of them must agree in order to remove the chairperson or vice chairperson.

(8) Actions of the task force may be taken only by a majority vote of a quorum of the task force.

50317. Regulatory Authority.
(a) The Franchise Tax Board may adopt any and all regulations that are helpful and appropriate for implementing any provision in this Part.
(b) Until January 1, 2024, the Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code) shall not apply to any regulation, standard, criterion, procedure, determination, rule, notice, guideline, or any other guidance established or issued by the Franchise Tax Board pursuant to this Part.

SEC. 2. This act provides for a tax levy within the meaning of Article IV of the California Constitution and shall go into immediate effect.