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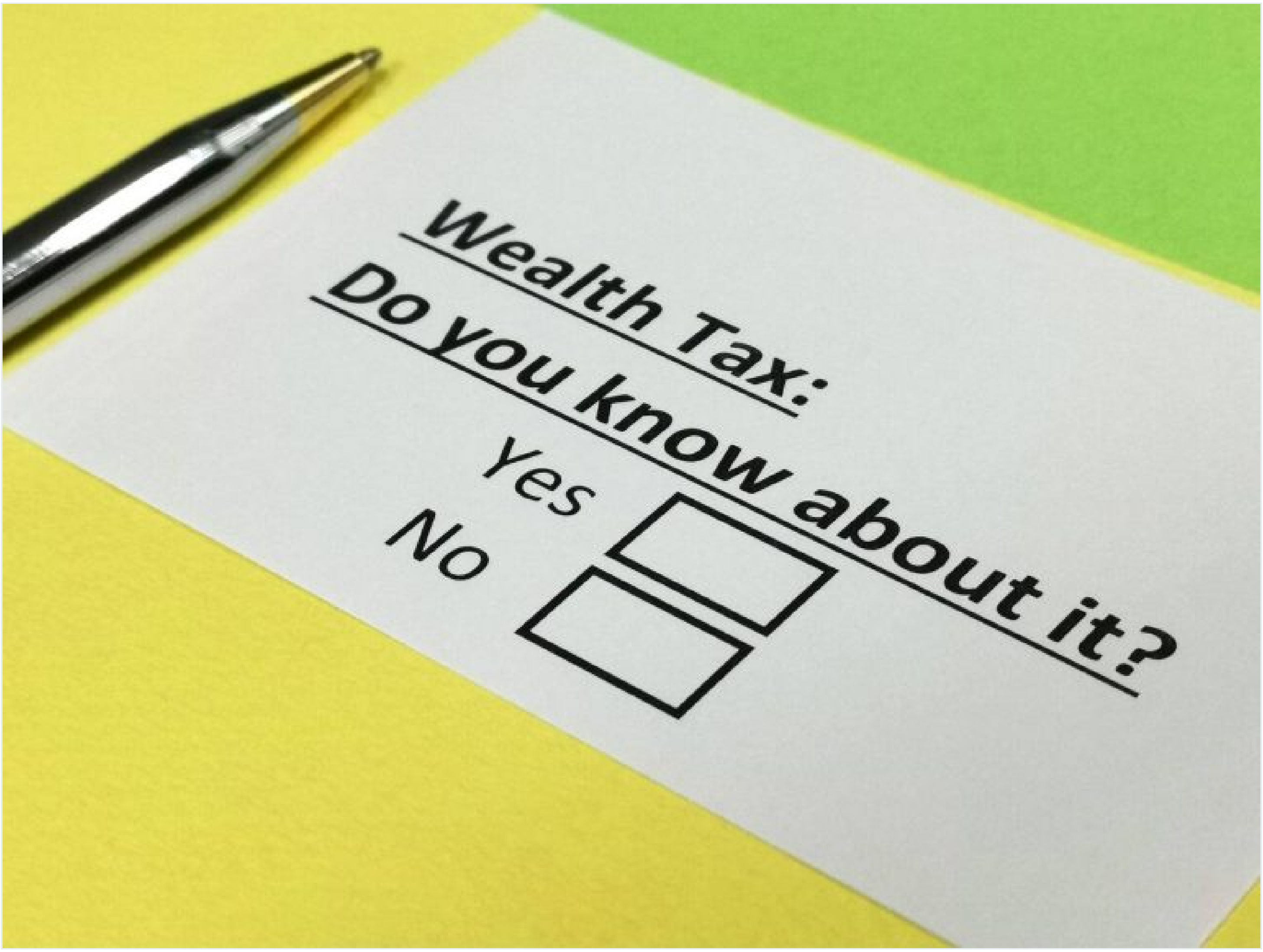
potential federal wealth tax.

Oct. 04, 2023



By Bruce Willey, JD, CPA, Kiplinger Consumer News Service (TNS)

Now that the U.S. Supreme Court has agreed to take up a lower court decision on taxation (*Moore v United States*) that could open or slam the door on a federal wealth tax, it's worth a deep dive into just how terrible a wealth tax would be for American

in California, Connecticut, Hawaii, Illinois, Maryland, New York, Oregon and Washington have all seen wealth tax bills introduced this year.

A wealth tax has all the existing bad features of the current income tax—complex, expensive to administer, costly to comply with, subject to manipulation and avoidance by those with the most resources and badly distorting of economic activity and capital formation.

But it's much worse. And here's why, practically speaking.

First, a wealth tax violates the long-standing American principle that we're allowed to build wealth and grow the value of assets and that we don't pay taxes on that growth until we dispose of the asset. In effect, a wealth tax imposes what can be thought of as a third level of taxation—after income tax and capital gains tax—on the most productive drivers of the U.S. economy.

Second, no matter how it's positioned, a wealth tax is not based on objective facts. It's subjective, because wealth must be appraised, and appraisals are opinions. Marketable securities are easy to mark to market. But how about stock in private companies? How about large real estate holdings? How about a stamp collection? How about a franchise contract?

A large proportion of tax court cases come about because of disputes over what the IRS thinks an asset is worth and what the taxpayer says it's worth. Can you imagine the chaos when every asset of every wealthy taxpayer has to be annually evaluated and assessed?

Third, don't for a moment imagine that the wealth tax will remain on "the wealthy." The U.S. income tax when created in 1913 had a 1% bracket that jumped to 6% if your income was above about $14 million in today's dollars. That, of course, is not where the top tax bracket stayed, hitting 77% just five years later.

Who decides who's wealthy and who isn't?

You can bet that all sources of wealth—retirement savings like Roth IRAs, your pension fund value, money you've socked away for your kids' and grandkids' education—will be fair game for the wealth-tax man.

Such a tax is fuel for financial nightmares. What happens when an asset-rich, cash-poor taxpayer, such as a farmer, doesn't have enough liquidity to pay their wealth tax? The answer: forced sales. What happens in forced sales? The seller is almost always under distress and has to sell at low prices.

And who's got the liquidity to scoop up distressed assets at a discount? The wealthiest among us. So the wealth tax isn't in any way equitable and doesn't just cost what the government requires—it also does active damage to the portfolios of the taxed.

Would the IRS offer taxpayers a credit in years that asset values and the stock markets plunge? Hardly. Think of a wealth tax as a one-way ratchet growing tighter and tighter around your wallet.

A flawed way to raise revenue?

Worst of all, wealth taxes don't seem to work for raising revenue. Norway recently tried increasing the tax rates for a wealth tax it had instituted, only to see tax collections that were projected to rise by about $150 million annually instead plunge by an estimated $594 million, according to the American Institute for Economic Research.

Why doesn't it work? In part because wealth taxes will be most easily avoided by the wealthiest individuals. Turns out, the truly wealthy among us are the most mobile, and seeing nothing in place to stop an endless stream of future wealth tax increases, they picked up and left the country.

(Even stopping short of leaving the jurisdiction, they can afford the best tax lawyers,

require extensive investigative power on the part of the government. What's that antique car worth in your garage? What is the revenue growth rate of your company? How did you calculate the value of your lakeside cottage now that you put the new boat dock in?

Those 87,000 new IRS agents the government is hiring? That's a drop in the bucket if a wealth tax were to be instituted. The level of required recordkeeping and disclosure, the investigations, the dispute procedures, the court cases … The main effect of a wealth tax will be the creation of an entirely new industry devoted to avoiding the wealth tax.

Such a dynamic would be installed just as we've reached all-time lows in Americans' trust of government, according to Pew Research Center. Evidence of the politicization of government agencies, which is troubling enough when taxation is based on relatively objective transactional data, will foster white-hot emotions when the government gets to make subjective assessments of what you owe.

What you can do

For myriad reasons, a federal wealth tax is a very scary prospect. Having done battle with the IRS on behalf of taxpayers for the last three decades, not a lot of things keep me awake at night. This is one of them.

My strong suggestion to all taxpayers—but especially to business owners, founders, entrepreneurs and executives—is not to sleep on this one. Talk to your representatives. Monitor the progress of *Moore v United States*. Let other people know about the insidious nature of wealth taxes. And help nip this nascent movement right in the bud. A U.S. federal wealth tax would be economically disastrous, and there'll be no turning back once it's instituted.

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