HOW TO MEASURE AND VALUE WEALTH FOR A FEDERAL WEALTH TAX REFORM

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APRIL 2021

ROOSEVELT INSTITUTE

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ACKNOWLEDGMENTS

The authors thank Greg Leiserson and Bharat Ramamurti for their insights and feedback. This project was funded in part by Liesel Pritzker Simmons and Ian Simmons. Roosevelt staff Ivan Cazarin, Emily DiVito, Suzanne Kahn, Matt Hughes, Sonya Gurwitt, Tayra Lucero, and Victoria Streker also contributed to the project.

INTRODUCTION

Over the last several decades, wealth inequality has exploded,[1] warping economic outcomes and limiting opportunity—for individuals and for the US at large.

Sky-high income inequality and runaway income gains for the nation's highest earners compound that wealth inequality and are insufficiently taxed under the current tax regime.

Further, wealth in the US has always been heavily skewed by race.[2] Since the country's founding, US laws and customs have prevented Black and brown people from receiving fair wages and accruing assets,[3] thereby creating and perpetuating today's massive racial wealth gap.[4]

While our existing tax systems are ill-equipped to tackle these challenges,[5] a well-designed, high-end wealth tax could both help level the playing field and promote shared economic prosperity.

The existing US income tax regime is cash realization–based and thus mostly takes a deferral-based approach to valuation of the economic income derived from

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1 ***E.g.***, Emmanuel Saez & Gabriel Zucman, ***Wealth Inequality in the United States Since 1913: Evidence From Capitalized Income Tax Data***, 131 Quarterly Journal of Economics 519–578 (2016), https://academic.oup.com/qje/article/131/2/519/2607097; Emmanuel Saez, ***Income and Wealth Inequality: Evidence and Policy Implications***, 35 Contemporary Economic Policy 7–25 (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2873965; Anthony B. Atkinson, Thomas Piketty & Emmanuel Saez, ***Top Incomes in the Long Run of History***, 49 Journal of Economic Literature 3–71 (2011), https://www.aeaweb.org/articles?id=10.1257/jel.49.1.3.

2 ***See***, e.g., Anne Price, Roosevelt Institute and Insight Center for Community Economic Development, ***Don't Fixate on the Racial Wealth Gap: Focus on Undoing Its Root Causes***, February 2020, https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI_DontFixateRWG_Report_202001.pdf.

3 ***See***, e.g., Matthew Desmond, New York Times Magazine, ***In Order to Understand the Brutality of American Capitalism, You Have to Start on the Plantation***, August 14, 2019, https://www.nytimes.com/interactive/2019/08/14/magazine/slavery-capitalism.html; Trymaine Lee, New York Times Magazine, ***A Vast Wealth Gap, Driven by Segregation, Redlining, Evictions, and Exclusion, Separates Black and White America***, August 14, 2019, https://www.nytimes.com/interactive/2019/08/14/magazine/racial-wealth-gap.html.

4 ***See***, e.g., Neil Bhutta, Andrew C. Chang, Lisa J. Dettling & Joanne W. Hsu, Board of Governors of the Federal Reserve System, ***Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances***, September 29, 2020, https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm.

5 David Gamage & John R. Brooks, ***Tax Now or Tax Never: Political Optionality and the Case for Current-Assessment Tax Reform***, 100 North Carolina Law Review (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3801164; Ari Glogower, ***Taxing Inequality***, 93 New York University Law Review 1421, 1424 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3302097 ("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 Law Review 1, 1 (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2749422 ("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 Michigan Law Review 807, 920 (2005), https://repository.law.umich.edu/mlr/vol103/iss5/1/ ("Taxes on capital are easily avoided and virtually voluntary").

wealth accumulations—an approach to valuation that can be politically fragile and extremely vulnerable to gaming.[6]

To achieve meaningful progressive taxation of the very wealthy, we should instead value and tax income and wealth in real time.

Encouragingly, this strikes many as an obvious solution,[7] and governments around the world are now considering wealth tax proposals.[8] In the US, the 2020 presidential campaigns of Senators Elizabeth Warren (D-MA) and Bernie Sanders (I-VT) brought the idea to the national stage. Their proposals to tax the wealth of multimillionaires and billionaires generated broad public support—even among many Republicans[9]—and broadened the conversation over the future of progressive tax reform.

Fundamental to the design of a wealth tax is how to measure and value taxpayers' wealth.[10] This report outlines a practical approach to doing so that can form the basis of federal wealth tax legislation.

In general, the proposed wealth tax would value assets at their fair market value, the notional price at which the asset would voluntarily change hands between an informed buyer and seller, both operating at arm's length. Beyond this general rule, assets and liabilities that are hard to value would be subject to additional rules for measuring fair market value.

As this report will explain, although there are many difficulties involved in designing a valuation and measurement system, these difficulties are not inherently more challenging when it comes to designing and implementing a

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[6] Gamage & Brooks, ***supra*** note 5. It is similarly possible to design a wealth tax based on cash realization and deferral-based approaches to valuation, but this is not advisable because such a wealth tax would likely be politically fragile and vulnerable to gaming. For prior proposals for realization-based wealth tax reforms, ***see*** Greg Leiserson, ***Taxing Wealth***, in Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue, at 107–114 (Moss, Nunn & Shambaugh, eds., 2020), https://www.brookings.edu/multi-chapter-report/tackling-the-tax-code-efficient-and-equitable-ways-to-raise-revenue/; James Kwak, ***Reducing Inequality with a Retrospective Tax on Capital***, 25 Cornell Jorunal of Law and Public Policy 191–244 (2015), https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1426&context=cjlpp.

[7] ***E.g.***, Howard Schneider & Chris Kahn, Reuters, ***Majority of Americans Favor Wealth Tax on Very Rich: Reuters/Ipsos Poll***, January 10, 2020, https://www.reuters.com/article/us-usa-election-inequality-poll/majority-of-americans-favor-wealth-tax-on-very-rich-reuters-ipsos-poll-idUSKBN1Z9141; Matthew Yglesias, Vox, ***Taxing the Rich is Extremely Popular***, February 4, 2019, https://www.vox.com/2019/2/4/18210370/warren-wealth-tax-pol.

[8] Ben Steverman & Benjamin Stupples, Bloomberg Tax, ***Wealth Taxes Are Going Global, From California to Germany***, January 6, 2021, https://news.bloombergtax.com/daily-tax-report-international/wealth-taxes-are-going-global-from-california-to-germany.

[9] ***See***, e.g., Schneider & Kahn, ***supra*** note 7.

[10] Stephen Daly & Glen Loutzenhiser, ***Wealth Tax Commission: Valuation***, Wealth Tax Commission Evidence Paper No. 9, at 3 (2020), https://www.wealthandpolicy.com/wp/109.html ("Valuation issues are frequently cited in the literature as the most problematic aspect of wealth taxes").

wealth tax than they are for designing and implementing an income tax. For either an income tax or a wealth tax, there is no perfect valuation or measurement system, and trade-offs must be made amongst potentially conflicting goals.

Measuring wealth can sometimes be complicated and will require additional funding and capacity for the Internal Revenue Service (IRS) or other additional enforcement mechanisms, along with sometimes complex-seeming rules—but these administrative costs are low compared to the revenue at stake if valuation and enforcement are not taken seriously. Additionally, so long as a wealth tax is designed with a high exclusion threshold, only the wealthiest taxpayers—those with complicated wealth holdings and excellent legal and accounting help—would face any thorny valuation issues or compliance obligations.

This report will explain the best approaches for valuing the most important categories of taxpayers' wealth, both for forms of wealth that are relatively easy to value and for forms of wealth that are more difficult to value.

A LARGE PORTION OF WEALTH HOLDINGS ARE EASY TO VALUE

According to the most recent data available from the IRS, about half of the wealth holdings of individuals with more than $5 million of net worth are held in "publicly traded or readily valued" forms. These include publicly traded stock, bonds, mutual funds, retirement assets, mortgages and notes, life insurance, and cash. The extremely wealthy tend to hold more wealth on average in hard-to-value assets, but evidence implies that even for taxpayers with net worth of more than $50 million, a large portion of wealth holdings are relatively easy to value.[11]

[11] Authors' calculations per IRS, ***Personal Wealth 2013: Top Wealth Holders, Type of Property by Size of Net Worth***, January 2018, https://www.irs.gov/statistics/soi-tax-stats-all-top-wealthholders-by-size-of-net-worth.

TABLE 1. SHARES OF ASSETS WHERE THE WEALTHY HOLD THEIR WEALTH[12]	
Neither publicly traded nor readily valued	**48%**
Real estate	14%
Closely held stock	13%
Noncorporate business assets	10%
Farm assets	4%
Private equity and hedge funds	4%
Other (other limited partnerships, art, unallocated investments)	3%
Publicly traded or readily valued	**52%**
Publicly traded stock	19%
Bonds (government, corporate, funds)	10%
Retirement assets	7%
Cash assets	9%
Mortgages and notes	3%
Other (mutual funds, insurance, other assets)	4%

PUBLICLY TRADED ASSETS

Market-trading price at the close of markets on December 31

For publicly traded assets, valuation for a wealth tax is relatively straightforward, and would be based on the market-trading price of the asset at close of markets on December 31.

To prevent taxpayers from gaming these rules through transactions designed to temporarily reduce market value at the end of the year, this approach requires anti-abuse rules similar to those that have been adopted for the existing mark-to-market provisions of the US income tax; those provisions similarly conduct valuation based on end-of-year market-trading prices.[13] Adopting anti-abuse rules

[12] *Ibid*. This table reports the most recent IRS personal wealth data for individuals with net wealth over $5 million in 2013. Its category titling and ordering are modeled on a table previously produced in David Kamin, ***How to Tax the Rich***, 146 Tax Notes 119 (January 5, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2550936. Its categories are illustrative. This report breaks these categories down further in making recommendations for valuing specific assets.

[13] IRC Secs. 475 & 1256 and Treas. Regs. 1.475-0 through (g)(1).

of this sort for publicly traded assets under a wealth tax could be accomplished in essentially the same manner.

To improve enforcement and to ease administrative and compliance burdens, third-party information reporting of end-of-year valuations should be required.[14] Information reporting has been shown to be highly effective at ensuring that taxpayers comply in paying taxes on items subject to information reporting.

INTEREST-BEARING SAVINGS ACCOUNTS, CASH, AND OTHER DEPOSITS

Reported and valued at dollar cash value at the end of the day on December 31.

All interest-bearing savings accounts, cash, and other deposits should be required to be reported and valued at their dollar cash value as of the end of the last day of each tax year.

As with publicly traded assets, anti-abuse rules similar to those that have been adopted for the existing mark-to-market provisions of the US income tax should be adopted to prevent gaming transactions that would temporarily reduce assessed value on that day, and banks and brokerages could be required to submit information reporting to ease administrative and compliance burdens and to ensure compliance.

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[14] This is already done for capital income within the income tax. See Internal Revenue Service (IRS), *2021 General Instructions for Certain Information Returns*, Department of the Treasury, January 6, 2021, https://www.irs.gov/pub/irs-pdf/i1099gi.pdf; Internal Revenue Service (IRS), *Cost Basis Reporting FAQs*, https://www.irs.gov/businesses/small-businesses-self-employed/cost-basis-reporting-faqs.

SOME ASSETS ARE MORE DIFFICULT TO VALUE, AND REQUIRE SPECIFIC APPROACHES DEPENDING ON THE ASSET TYPE

Another large portion of wealth is held in a variety of asset categories that are relatively harder to value, requiring somewhat different valuation approaches. The sections that follow lay out a recommended approach to valuing assets in each of several important asset classes, including real estate, interests in private businesses, and interests in trusts.

The gold standard for valuation is to derive fair-market-value prices from current or recent arm's length transactions.[15]

Difficulties arise when valuations cannot easily be derived from any current or recent arm's length transactions, but there are a number of ways to gain useful information about an asset's value even when that asset has not been sold or marketed recently.

One approach to valuation is to rely on appraisals, whereby hired expert third-party appraisers combine information from the taxpayer with knowledge of the relevant markets to determine likely market value. This is the approach most often used by the existing US estate and gift tax regimes and by the existing US income tax regime for valuing tax-deductible charitable donations of property.

Other valuation approaches include using prospective formulas that adjust the purchase price by some standard factor to arrive at current value, or using proxy-based formulas to derive valuations from more observable information that can serve as a substitute for prices obtained from arm's length transactions (examples include valuing privately held businesses based on book value or based on a blended formula of book value and book profits[16]).

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[15] Leandra Lederman, *Valuation as a Challenge for Tax Administration*, 96 Notre Dame Law Review 14 (forthcoming 2021), https://ssrn.com/abstract=3760600.

[16] Jean-Blaise Eckert & Lukas Aebi, ***Wealth Tax Commission: Wealth Taxation in Switzerland***, Wealth Tax Commission International Background Paper, at 6 (2020), https://www.wealthandpolicy.com/wp/BP133_Countries_Switzerland.pdf. ("A company's value is determined by calculating the weighted average of its 'earnings value' and its net asset value [i.e., fair market value of assets minus liabilities]").

Many assets are already routinely valued for tax or business purposes, and while these valuations are imperfect, they can provide important data for informing wealth tax valuations done either through appraisals or through prescribed formulas.

Each valuation approach has distinct strengths and weaknesses, and these can vary depending on the type of asset being valued. No single one of these approaches can function as a silver bullet for valuing hard-to-value assets, but used together, they can provide reasonably accurate, administrable annual valuation of non-traded, hard-to-value assets.

Thus, along with recommending increased IRS funding and expanded resources and enforcement tools, we recommend a hybrid approach that relies on both formulaic valuation approaches and appraisals.[17]

Additionally, while we suggest ways to arrive at current-year valuations for all assets, in some cases we suggest adding retrospective "look-back" rules to reduce the possibility of aggressive undervaluation. While deferring valuation entirely until assets are sold creates many problems,[18] the eventual sale price of an asset can provide useful information about the value of the asset that can be used to correct past undervaluation and deter gaming on the part of taxpayers.

REAL ESTATE ASSETS

Valued at the greater of local government assessments or a formulaic minimum value.

A substantial portion of the wealth of very wealthy taxpayers is held in real estate. Unlike some of the asset classes discussed below, many real estate assets are already valued regularly for tax purposes: Valuation is generally already being conducted by local government tax appraisers for local property taxes. However, such appraisals may not be available for all such assets, especially for foreign real estate assets.

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17 For elaboration on this point, see David Gamage, ***Five Key Research Findings on Wealth Taxation for the Super Rich*** (July 27, 2019), at 9–12, https://ssrn.com/abstract=3427827.

18 See notes 37–39 and accompanying text *infra*.

In general, because local government agents are typically performing these valuations themselves, we expect these valuations to be less easily gameable than appraisal-based valuations where the appraisers are hired by taxpayers.[19] Yet some states and localities—such as in California—have stringent property tax limitation measures that make local government appraisals of limited use for wealth tax purposes.[20] Even in the absence of such property tax limitation measures, the literature finds that local government appraisals often substantially underestimate the value of real estate assets.[21]

We thus suggest using local government appraisals as one basis for wealth tax valuations of real estate, but combining these with a minimum value formula to limit the extent to which undervaluation by local authorities can reduce federal wealth taxes.

Such a minimum value formula could start with the most recent purchase price of the property, plus the costs of any improvements (which should already be tracked for basis purposes for the income tax); then adjust that value by applying an IRS-published rate of return for each year or partial year since the purchase took place, making proper adjustments for any later improvements, depreciation, or other events that would affect the value of the property. The IRS could publish annual average growth rates for real estate values by zip code or by other geographic designations, which should be reasonably straightforward to approximate based on readily available digital real estate transactions data.

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19 ***See***, e.g., Lederman, ***supra*** note 15 at 4 ("For example, even the valuation of real estate, which has highly developed systems of comparables, varies widely in quality across United States [US] jurisdictions that impose property taxes. This measurement issue can be ameliorated with improvements in technology and methodology. For example, computers make the use of comparables in real estate valuation faster and more systematic than it would otherwise be. Improvements in technology do not necessarily eliminate valuation disputes, however. In fact, they can make valuation litigation more expensive"); James R. Repetti, ***Commentary: It's All About Valuation***, 53 Tax Law Review 611 (2000) ("There is a strong case, however, that real estate should be placed into the hard-to-value category. Many municipalities and states already engage in the valuation of real estate for purposes of their property taxes. The results have been poor. One commentator observed that the general quality of valuation in municipalities is abysmal. Another commentator argued that the 'inherent subjectivity involved in the appraisal of real property means that the process of appraising can never be an exact science.' This inherent subjectivity would invite litigation, and taxpayers would have a strong economic incentive to seek a low valuation"); Edward A. Zelinsky, ***For Realization: Income Taxation, Sectoral Accretionism, and the Virtue of Attainable Virtues***, 19 Cardozo Law Review 861, 881 (1997), https://larc.cardozo.yu.edu/cgi/viewcontent.cgi?article=1221&context=faculty-articles ("It is true that real property appraisers have developed extensive and sophisticated data bases and valuation formulas. However, these are available to the taxpayer as well as to the tax collector. Consequently, adjudicators in real estate appraisal cases today find themselves wading through more and more information presented by the parties' experts; the existence of sophisticated data bases [and the arguments to accompany them] facilitates taxpayers' fact-intensive challenges to the government's determinations. . .").

20 Office of the Assessor, County of Santa Clara, ***Understanding Proposition 13***, https://www.sccassessor.org/index.php/faq/understanding-proposition-13.

21 ***See*** note 19 ***supra***. Moreover, there are troubling racially disparate impacts that result from undervaluation. ***See*** Andrew T. Hayashi, ***Dynamic Property Taxes and Racial Gentrification***, University of Virginia School of Law Public Law and Legal Theory Paper Series 2020-80 & Law and Economics Paper Series 2020–21 (December 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3751500.

This approach should provide a good rough minimum valuation, but it will become less accurate as time passes after the purchase of the asset. We thus suggest that a certified appraisal should be required for real estate subject to the wealth tax at least once every 10 years. For properties that were not purchased within the past 10 years, these appraisals should then be used in place of the purchase price as the starting point for the minimum value formula. That is, the appraised value would be adjusted for each year or partial year since the appraisal was conducted in the same manner as for adjusting purchase price information, described above.

Taking the greater of either local government appraisals or a formula-based value would provide reasonably accurate values that should suffice for valuing most real estate assets. However, this approach may still undervalue some properties, especially in jurisdictions where local government appraisals are known to be especially inaccurate, or for properties where local government appraisals are not available. For such properties, valuation can be further strengthened through look-back rules that would apply when and if properties are eventually sold. While purely retrospective valuation techniques are problematic,[22] valuation overall can be improved through the addition of look-back rules. When a property subject to the wealth tax is sold in an arm's length exchange, the sale price should be required to be reported on that year's wealth tax return so that past undervaluation in jurisdictions where local government appraisals are known to be especially unreliable can be corrected through a formula that works backward from that eventual sale price.[23]

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[22] See notes 37–39 and accompanying text *infra*.

[23] Specifically, annual deemed values for prior years could be derived by applying published annual growth rates to the sale price—in effect reversing the formula for adjusting purchase prices and prior certified appraisals explained above. These retrospective valuations could then be compared to the values claimed on past wealth tax returns, and additional tax and interest could be paid for any year in which the retrospective approach yields a higher value. While this may sound complex, all of the necessary data should be accessible—and formulas computable—within the taxpayer's accounting software.

INTERESTS IN PRIVATELY OWNED BUSINESS ENTITIES

Small businesses are valued formulaically based on their reported book value; larger businesses are additionally subject to appraisals.

Another substantial portion (roughly 18 percent) of the wealth held by very wealthy taxpayers is in the form of ownership or other interests in privately owned businesses.[24] These businesses can be small, family-owned firms (or solo service providers), or large, multibillion-dollar companies with tens of thousands of employees. These can be solely owned, or divided among large numbers of owners with complex, opaque interests.

Tax authorities often have very little information about the inner workings of these entities, large and small. Privately owned business entities thus present some of the most serious valuation and measurement challenges for either wealth tax or income tax design.

For publicly traded businesses, interests (shares) are traded regularly, making their market value relatively straightforward to determine. They are also subject to extensive reporting requirements, so that buyers and sellers can make informed decisions.

Privately held businesses, on the other hand, can exist for decades without any sale or exchange of interests, and can operate in relative secrecy. This makes it difficult to know how much a company, or a given ownership share in that company, would be worth on the open market. But operating businesses do keep records of their assets and liabilities, as well as profits and losses, and are often already required

[24] Board of Governors of the Federal Reserve System, ***DFA: Distributional Financial Accounts***, December 18, 2020, https://www.federalreserve.gov/releases/z1/dataviz/dfa/compare/chart/#quarter:124;series:Assets;demographic:networth;population:all;units:shares.

to do so in accordance with generally accepted accounting principles.[25] This information can be used to create formulaic valuations that, with the addition of sale and appraisal information where available and appropriate, can create reasonably accurate valuations without large compliance costs.

For smaller businesses, the primary valuation rule should be based on a formula built on book value.[26] It is relatively straightforward to require private companies to report their book value—the net value of all assets and liabilities on the company's balance sheet. Many privately held companies are already required to report book values in accordance with generally accepted accounting principles, and these requirements could be expanded more broadly.

Simply adopting the book value of a business as its value for wealth tax purposes, however, would seriously undervalue many privately held business entities.[27] Book value is essentially the accounting value (typically cost plus or minus improvements or depreciation) of the assets of the company, minus any liabilities. It does not take into account the value of the business's workforce or future prospects, and there are many assets for which book value is substantially less than what the assets would fetch in a sale.

We thus suggest departing from a pure reliance on book value and instead grossing up book value by a factor determined by the IRS to correct for the mismatch between book value and market value, or else adding a multiple of book profits to correct for this mismatch. To implement the former approach, the

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25 ***See*** Douglas A. Shackelford, Joel Slemrod & James M. Sallee, ***A Unifying Model of How the Tax System and Generally Accepted Accounting Principles Affect Corporate Behavior***, NBER Working Paper 12873, at 5 (2007), https://www.nber.org/papers/w12873 ("The financial disclosures must conform to Generally Accepted Accounting Principles [GAAP]. Penalties for failure to comply include restating prior statements, losing access to the public capital markets, and criminal proceedings against managers. GAAP comprises accounting conventions that have evolved over decades to provide guidance about the information that firms should disclose through their financial reports. GAAP provides a structure for identifying, evaluating, and reporting the firm's activities so that financial disclosures are relevant, reliable, comparable, and consistent. The Financial Accounting Standards Board [FASB], with oversight from the SEC, is the primary standard setter of GAAP. The American Institute of Certified Public Accountants, the Emerging Issues Task Force, and the SEC itself also contribute to GAAP").

26 ***See*** Daly & Loutzenhiser, ***supra*** note 10, at 17 ("In specie transfers do not present a readily available fix to the issues in respect of smaller private businesses. Instead, a formula based on book value as adopted in Switzerland seems the most plausible option to be adopted. It provides certainty for taxpayers, is administratively efficient, is unlikely to lead to significant disputes, is quick, scalable and comes generally with frequent valuations, albeit at a cost in terms of horizontal equity [with under and overvaluations] and robustness [with the ability to game values] meaning that anti-avoidance rules and measures to mitigate hardship at the margins would be needed").

27 ***Ibid.*** at 16 ("Book values meanwhile are problematic as they may not reflect current asset values but rather the original cost, intangible assets may not be recorded . . . and, in the case of distressed companies, would overstate the amount that the assets would likely fetch on sale . . . Whilst a cost approach can be a legitimate approach for determining open market value, the book value approach here does not incorporate fully the cost of replacing the assets. Thus, if a formulaic book value approach is adopted, steps must be taken to ensure that the asset values reflect current values").

IRS could publish multiple different factors based on industry or other business characteristics to arrive at more precise valuations. To implement the latter approach, a multiple of book profits could be added to the book value formula,[28] either by using the same multiple for all businesses or with the IRS publishing different multiples for different types of businesses.

These formulaic valuations should either be structured as deemed valuation rules that are not challengeable by taxpayers or as rebuttable presumptions that can only be challenged through the taxpayer substantiating any lower value asserted with a heightened standard of proof.

For larger businesses—those with adjusted book value of more than, say, $50 million—a certified appraisal should also be required as a minimum valuation backstop, so that the business would be valued at the greater of the appraisal value and the formula-based value. Appraisals will often be more accurate for businesses with significant market value beyond what their current profits and balance sheet would suggest, but maintaining the formula-based valuation as an alternative floor should reduce the ability of taxpayers to aggressively game these appraisals.[29]

To facilitate wealth tax assessments and to ease compliance, information reporting should require that every business entity with at least one US taxpayer owner, whether foreign or domestic, annually report all of: (a) the percentage ownership interest of each US taxpayer owner, (b) the book value of the business entity according to generally accepted accounting principles, and (c) the annual book profits of the business entity according to generally accepted accounting

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28 This is the approach used by Switzerland's wealth tax. ***See*** Eckert & Aebi, ***supra*** note 16, at 6 ("A company's value is determined by calculating the weighted average of its 'earnings value' and its net asset value [i.e., fair market value of assets minus liabilities], thereby counting the earnings value twice. The earnings value is determined by capitalizing the adjusted average net profit of the last two or three years with a capitalization rate [of currently 7 percent], which applies uniformly to all industries").

29 Many of the thorniest issues with privately owned businesses come about because they are held for many years or decades without a sale or transfer. But when arm's length transactions do occur, these events can provide a strong signal of the true market value of the business at the time of sale. It may thus be useful to supplement the primary valuation rules discussed above with additional minimum valuation rules, at least for certain specified forms of businesses or transactions where valuation may be especially problematic. These additional rules could work forward from relatively recent purchase prices, or else could work backward from eventual sale prices, or could even use both of these approaches. For instance, a forward-looking rule could apply if, within the prior 10 years, there has been a sale, partial sale, or any other event that sets the value of the entire business or its assets based on an arm's length transaction. Then, the taxpayer could be required to report the valuation derived from that arm's length transaction and then adjust that valuation by standard factors that could be published by the IRS, with this then becoming the minimum value of the business enterprise. A backward-looking rule could similarly be made to apply if there is eventually a sale or other arm's length exchange, with the taxpayer then being required to both report that valuation and then also derive prior-year valuations by adjusting that sale-price valuation by standard factors. The taxpayer could then be required to pay additional tax if these backward-looking valuations implied that the prior-year valuations were too low.

principles. Rules similar to the Foreign Account Tax Compliance Act (FATCA) should then be imposed on any foreign business entities, with any US taxpayer owners required to terminate their ownership interests if the business entity does not comply.[30]

To prevent taxpayers from taking advantage of any differences in how assets held within privately owned businesses are valued as compared to assets held directly, the wealth tax should apply look-through rules for holding companies or for publicly traded securities and other investment assets owned by privately held businesses.[31] Such look-through rules could deter taxpayers from stuffing publicly traded securities or other investment assets into privately owned business entities as part of gaming transactions meant to lower the valuations reported for wealth tax purposes.

INTERESTS IN TRUSTS

Wealth tax is assessed at the trust level at the highest wealth tax rate, with no exemption except in specified circumstances.

Trusts are legal arrangements that allow a third party (the trustee) to hold assets for the benefit of others (the beneficiaries). They are often used in estate planning to determine when and how assets are passed from one generation to the next. If a wealth tax did not apply to trusts, they would be an easy means of avoiding the tax.

The easiest solution is to assess wealth tax at the trust level, with no exemption, based on the logic that most trusts are created by wealthy individuals and families, and then require trusts to report and remit the wealth tax directly. Removing the exemption would prevent taxpayers from avoiding taxes by dividing their wealth into multiple trusts.

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[30] This could be enforced through penalties on US taxpayer owners who do not terminate their ownership interest in foreign businesses that fail to comply with the information reporting rules. Compliance could further be enhanced through coordinated international information exchange agreements. For explanation of FATCA's requirements, see William H. Byrnes, Denis Kleinfeld & Alberto Gil Soriano, ***LexisNexis® Guide to FATCA Compliance (Chapter 1, Background and Current Status of FATCA)***, Thomas Jefferson School of Law Research Paper No. 2457671 (2014), http://ssrn.com/abstract=2457671.

[31] For instance, the Swiss wealth tax applies look-through rules to privately held businesses deemed to be "passive investment companies," ***see*** Eckert & Aebi, ***supra*** note 16, at 12.

This solution would be easiest to implement for a flat-rate wealth tax. For a wealth tax with graduated rates, this solution would work best if assets held within trusts were subject to the top wealth tax rate.

Taxing trusts separately with no exemption could have the effect of imposing a greater relative tax on wealth held through trusts, as compared to wealth held directly by the taxpayer. Of course, taxpayers could always avoid this additional burden by holding assets directly, rather than through trusts. This effect could offer the additional advantage, however, of discouraging taxpayers from using trusts for tax-reduction purposes.

Limited exceptions to this regime could be offered for specified trusts. For instance, an exemption of 10 million dollars of wealth could be offered to any trust whose only beneficiaries are minor children or adults with disabilities, with the limitation that any such beneficiary could only designate a single trust to qualify for such exemption. If a qualifying beneficiary were the beneficiary of more than one trust, then all trusts other than the one designated by the beneficiary would lose the exemption.

Any foreign trusts with US beneficiaries should be required to either report and remit wealth tax at the trust level (under the same rules as US-based trusts) or else terminate all beneficiary interests of all US taxpayers. Penalty rules similar to those in FATCA should be used to enforce this.[32]

OTHER CATEGORIES OF ASSETS

Other valuable assets require a mix of the above approaches, coupled with robust IRS enforcement.

A number of additional asset categories pose valuation or compliance problems for a wealth tax. The general approaches described above can also be used to minimize the risk of undervaluation for these other categories of assets.

[32] As explained in note 30 ***supra***, this could be enforced through penalties on US taxpayer owners who do not terminate their interests in foreign trusts or by assessing an additional tax on all distributions to US taxpayer owners from foreign trusts that do not comply with the information reporting requirements. Compliance could further be enhanced through coordinated international information exchange agreements.

Notably, some types of assets, like Bitcoin and other cryptocurrencies, pose serious enforcement and compliance problems either for an income tax or a wealth tax, but are not especially difficult to value, as end-of-year dollar-valuations can be readily found from the same publicly available sources used for foreign currency deposits.

By contrast, other categories of assets, like valuable artwork, are more difficult to value unless there has been a recent sale or other arm's length exchange. For many such assets, there is no better alternative than requiring certified appraisals and then vigorously monitoring those appraisals through IRS audits.

For such assets that were purchased in an arm's length transaction within the past 10 years, valuation should be based at least in part on formulaic valuations working forward from the purchase price. For instance, the annual value could be deemed to be the purchase price adjusted by standard factors to be published by the IRS, with proper adjustment made for any substantial improvements or other events that would affect the basis of the assets for income tax purposes.[33]

For especially valuable assets, a certified appraisal should also be required at least once every 10 years, with the value used for wealth tax purposes then being the greater of either the formulaically adjusted purchase price or the certified appraisal value (formulaically adjusted in the same manner for years after the appraisal), as we previously suggested for privately held businesses.

For assets that were not purchased in an arm's length transaction within the past 10 years, the best option for a primary valuation methodology is to require that taxpayers submit certified appraisals, either annually or every 10 years, with appraisal values then adjusted in the same manner as explained above, except with appraisal values replacing purchase prices as the starting point for the formulaic valuations.

For some assets, it may be desirable to add an additional alternative minimum valuation rule that would apply either if any such asset were sold for more than some dollar-value threshold or if such assets in any year were collectively sold for more than some dollar-value threshold, with the alternative minimum valuation rule then using a backward-looking formula to determine whether any additional wealth tax might be owed with respect to prior years.

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[33] To effectuate this, the IRS could publish annual estimated growth rates for different categories of assets. For instance, assets specified as personal consumption assets could be adjusted by the published annual inflation rates.

Generally, all valuable assets should be included in the wealth tax base with annual reporting of valuation required.[34] However, for personal property, we suggest a de minimis exemption threshold of at least $50,000 in the aggregate. The purpose of this threshold would be to reduce the need for taxpayers to meticulously catalog and value a large number of relatively low-value personal belongings, and a reasonable exemption threshold for personal property should not substantially reduce revenues. As part of implementing the de minimis exemption threshold, taxpayers could be required to declare that the collective value of all assets not valued explicitly is less than the threshold, with significant penalties to be assessed if they were found to have excluded more than the allowed value of assets from reported valuations.

DEBTS AND LIABILITIES OWED BY THE TAXPAYER

Debts and liabilities are generally deductible, but with strict limitations to prevent gaming.

Because the base of a wealth tax is a taxpayer's net worth, debts and liabilities owed by a taxpayer should be reported and valued at their dollar cash value as of the end of the last day of the tax year, and then should generally be deductible against the taxpayer's wealth tax base.

However, anti-abuse rules are needed to limit the potential for gaming in the form of inflated or artificial liabilities so as to limit deductibility to only bona fide debts. There is a long history of taxpayers borrowing in non–bona fide ways to artificially create deductions for income tax purposes—for instance, with borrowing transactions designed so that the face value of the debt is high but with the debt structured in a way that it will never actually have to be paid.[35] Without sufficient anti-abuse rules, a wealth tax would undoubtedly be vulnerable to similar forms of abusive transactions.

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[34] With the exception of a few items that could be seen as economic wealth but are not well-suited to taxation under a net-worth tax: Employment and work-for-hire contracts should be excluded from the wealth tax base, as should intangibles like goodwill and human capital except insofar as these are either built into the value of distinct assets or are included as part of the rules governing interests in business entities or other asset categories above.

[35] Boris I. Bittker, ***Tax Shelters, Nonrecourse Debt, and the Crane Case***, 33 Tax Law Review 277 (1978), https://digitalcommons.law.yale.edu/fss_papers/2294/.

Debts can be divided into two categories: recourse and nonrecourse. Recourse debts and liabilities are those for which the taxpayer is personally liable. Nonrecourse debts are usually secured by specified assets or property, so that the lender can seize those assets if the borrower stops making payments, but cannot claim the borrower's other assets.

For nonrecourse debts and liabilities, the value of such assets securing the debts should be required to be reported along with the value of the debts and liabilities. The amounts deductible against net worth in any tax year on account of any nonrecourse debt or liability should then be limited to the amount included in net worth in that tax year on account of the assets securing the nonrecourse debt or liability.

Recourse debts and liabilities should generally be fully deductible against net worth, but only so long as the debt is owed to an unrelated party and with market rates of interest charged. Any debt or liability owed to a related party or for which no interest is charged, or for which clearly below-market rates of interest are charged, should be presumed to be an artificial liability, and should thus be nondeductible, except to the extent that the taxpayer can establish with a heightened standard of evidence that the liability is not artificial and is intended to be enforced on market terms.

CONCLUSION

Valuation and measurement are among the central challenges of designing any tax system, and especially so for a tax system designed to raise substantial revenues from the very wealthy. This report has explained how a wealth tax could use a combination of formulaic valuations and appraisals to arrive at sufficiently accurate valuations so as to minimize the opportunity for tax avoidance through undervaluation. Although this approach involves some complexities and imperfections, and will require increased IRS funding and other enforcement resources, these costs are relatively small compared to the revenue and equity considerations at stake.[36]

[36] Consider that Lily Batchelder and David Kamin estimate that a 2 percent wealth tax on the top 0.1 percent of tax households would raise $1.9–3.3 trillion over 10 years, depending on the degree of tax avoidance. If expanded to the top 1 percent, this wealth tax could raise $3.5–6.7 trillion. ***See*** Lily Batchelder & David Kamin, ***Taxing the Rich: Issues and Options***, (September 11, 2019), https://ssrn.com/abstract=3452274. For further discussion of both the revenue potential and equity stakes motivating the case for a wealth tax reform, see Gamage & Brooks, ***supra*** note 5, at Part II.

The alternative to confronting these challenges is to give up on the goal of achieving meaningful progressive taxation of the very wealthy.

As the economist C. Eugene Steuerle has explained, under the existing income tax, "[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."[37] This is because the existing US income tax is cash realization—based and thus mostly takes a deferral-based approach to valuation of the economic income derived from wealth accumulations.

It is theoretically possible to design a wealth tax that would similarly take a deferral-based approach to valuation.[38] However, in practice, deferral-based approaches to valuation have proven to be quite fragile when it comes to gaming by very wealthy taxpayers. Attempts to monitor such gaming face an uphill political battle, because the revenue that theoretically might be gained from bolstering anti-abuse rules and enforcement may not show up for many years or even decades—often outside of the operative budget window.[39]

Thus, to achieve meaningful progressive taxation of the very wealthy, to ensure that mega-millionaires and billionaires pay their fair share of tax, we should value and tax income and wealth annually in real time.

It should be understood that valuation and measurement are no more inherently challenging when it comes to designing and implementing a wealth tax than they are for designing and implementing an income tax. If we wish to pursue meaningful progressive taxation of the very wealthy, we must accept that perfection is unattainable when it comes to valuation and measurement, but that reasonably workable valuation approaches are available.

Through a combination of increased IRS funding and enforcement resources and a practical mix of formulaic valuations and appraisals, a wealth tax could be designed so as to raise substantial revenues from the very wealthy and restore equity to our tax system.

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[37] C. Eugene Steuerle, TaxVox, ***Individuals Pay Very Little Individual Income Tax on Capital Income***, September 6, 2018, https://www.taxpolicycenter.org/taxvox/individuals-pay-very-little-individual-income-tax-capital-income. See also Edward J. McCaffery, ***Taxing Wealth Seriously***, 70 Tax Law Review 305 (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2738848.

[38] ***See*** Leiserson, ***supra*** note 6; Kwak, ***supra*** note 6.

[39] Gamage & Brooks, ***supra*** note 5, at Part III.

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