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How to Tax the Ultrarich

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About the Author

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For KEW, who has always wanted the star footnote.

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Executive Summary

This report proposes a new tax, the Fair Share Tax (FAST), on very wealthy households. The FAST is imposed at sale like the current capital gains tax, but adds an interest-like extra tax on taxpayers who hold their assets for long periods. It therefore mimics the cash flows and economic incentives of a "mark-to-market" capital gains tax with a $15 million lifetime exclusion amount. Because it is collected at sale, the FAST is fully consistent with any possible constitutional limits that might rule out annual wealth or mark-to-market taxes. In addition, the FAST replaces the estate and gift tax system with an extra tax bracket for inherited property, in effect switching to an inheritance tax and carryover basis at death, but again with extra interest charges for taxpayers who delay sale.

The report also explores the economic, legal, and political rationale for the FAST and offers detailed descriptions of the legal rules needed to fit that rationale. Most importantly, it argues that US holders of vast wealth today enjoy opportunities to control social and political outcomes without spending their accumulated wealth. These facts make reforms to more effectively tax the ultrarich fairly urgent and imply that alternatives such as a value-added tax or other consumption tax would be ineffective at that goal.

Summary of Chapters

Chapter One: A FAST Overview

• The FAST gives the government a claim on all untaxed appreciation in excess of $15 million per household, payable at sale or other disposition of an asset. This claim yields the same government revenue as an annual 23.8 percent tax on gains, plus interest at the internal rate of return of each asset.

• Taxpayers can elect to prepay tax liability to eliminate additional interest charges on existing built-in gains. Assets are valued at prepayment under terms favorable to the government.

• Certain tax-avoiding transactions, such as income stripping payments, also trigger tax before sale.

• FAST liability stays with gift-givers during their life, and transfers to heirs at death.

Chapter Two: The Problem of Top-End Inequality

• The richest 340,000 Americans own one in every six dollars of private US wealth, in a nation of more than 340 million. The fortunes of these lucky few have grown three to four times faster than even other relatively well-off households over the past four decades.

• Highly concentrated wealth at these levels damages the mental and economic well-being of most everyone else. Highly unequal economies grow more slowly, suffer more crises, and experience higher inflation.

• Vast wealth offers unique benefits to owners that few others can enjoy, even if that wealth is never spent. Social science data now let us get a rough measure of the political and social power, and resulting personal satisfaction, that wealth brings.

• Wealth enables power and influence through direct control of information, supply chains, and jobs, as well as derivatively through promises to use that control to benefit others in exchange for favors. Even philanthropic wealth offers its controllers similar benefits.

Chapter Three: The Realization Dilemma

• Today's income tax is based on the realization principle, which taxes investment gains and losses only at the time an investment asset is sold.

• It is very difficult to implement a meaningful tax on the ultrarich using a realization-based tax system. Realization allows wealthy investors to choose when and where to sell, and because of the time value of money their resulting effective income tax rate is lower than for many middle-income families.

• Annual taxes on wealth or changes in wealth are potential alternatives to a realization-based system. A tax based on annual changes in wealth is known as a "mark-to-market," or MtM, tax.

• Recent legal developments at the Supreme Court raise questions about whether a comprehensive wealth or MtM tax would be constitutionally permissible.

Chapter Four: The Economics of Taxing Investments

• The economic case for taxing investment income is much more powerful when it applies to the ultrarich.

• Taxes on massive accumulations of wealth are efficient because that accumulation is an apt measure of the owner's ability to pay and the extent of the social damage caused by their disproportionate power and influence.

• Contrary to some creative recent scholarship, increases in wealth do in fact make the wealthy better off relative to others, even if that increase results from changes in interest rates.

Chapter Five: Implementation Challenges of Consumption Taxes

• Whatever economic theory might say about taxing investment income, in the real world a tax system that leaves out investment earnings of the rich would be deeply flawed.

• Taxes imposed at the cash register, such as a value-added tax (VAT), simply fail in the basic assignment of addressing top-end inequality. A VAT does burden the spending of the rich, but because the wealthiest households spend such a tiny share of their income, a VAT is a wealth tax only over the course of hundreds of years.

• Other approaches, such as the wage tax and cash flow consumption tax (CFCT), offer more progressivity, but economists who favor them have failed to recognize the fundamental legal obstacles both face.

• A wage tax has to distinguish compensation from investment, but that is a task that no global tax system in history has successfully managed. The only plausible legal approaches to resolving that problem raise similar constitutional issues as a wealth tax would.

• A CFCT has to distinguish investment from consumption, but that task is impossible legally and even conceptually in a country, such as ours, in which the wealthy can earn huge consumption value from the mere possession of wealth. A CFCT also faces dual constitution questions, related to whether imputed income and borrowing are constitutional "income."

• Proposals to tax wealthy households when they borrow also face a constitutional question about whether borrowing can be taxed, as well as practical questions of implementation.

Chapter Six: How Should Intergenerational Transfers Be Taxed?

• There is a compelling economic case for taxing massive inheritances more heavily than other investment income.

• Contrary to some prior commentary, massive inheritances should be taxed, not subsidized, because multigenerational control of policy and the economy demoralizes most individuals and saps economic growth.

• Fiscal systems should tax both the investment income of the present generation and the massive inheritances of the next.

• Legal systems around the globe struggle to collect taxes imposed as a result of death, whether on investment income or inheritance.

• Key legal tools for avoiding taxes at death include trusts and estate "freezes," in which a wealthy donor pays a small tax immediately to escape a much larger tax at death.

• In the US, massive amounts of wealth, likely in excess of $5 trillion, are now held in trusts that are permanently exempt from any form of estate or inheritance tax.

Chapter Seven: Retrospective Taxation

• So-called “retrospective” taxes offer a key alternative to annual wealth or MtM taxes.

• A retrospective tax is imposed at sale, but adds an additional interest-like tax charge to discourage property owners from holding assets in order to defer their tax.

• Depending on the design of the extra interest charge, a retrospective tax can reduce or eliminate the “lock-in” incentive a realization-based system usually creates.

• The most effective retrospective designs give the government a notional equity interest in each asset, so that the government shares in the owner’s risks and rewards but has no legal control over private property.

• A fully successful retrospective system also must impose at least some payments before realization.

Chapter Eight: A FAST Retrospective System

• The FAST is a retrospective, realization-based tax in which tax deferral does not give property owners any economic benefit; owners pay tax at sale and face an extra interest charge at their property’s internal rate of return when sale is deferred.

• Because it is imposed only at sale, the FAST is fully consistent with any constitutional restriction on taxation of unrealized gains, and this may be a reason to prefer it to other proposals.

• For budget and political-economy reasons, taxpayers can choose to prepay their FAST liability, subject to government-favorable rules for valuing assets.

• Certain tax-avoiding transactions, such as dividend payments to related parties, are treated as partial sales and also trigger tax.

• Even if the Constitution prohibits tax on unrealized gains, voluntary payments and narrow taxes designed as anti-abuse rules are both likely permissible.

Chapter Nine: Retrospective Taxation for Intergenerational Transfers and Trusts

• Imposing a higher rate of tax on very large inheritances is consistent with the long US history of the estate tax as well as making good economic sense.

• The FAST can replace the existing estate and gift tax by adding a 40 percent government interest in inherited property in excess of $15 million.

• The inheritance FAST is triggered when inherited assets are sold, ending the valuation games that trouble the estate tax and easing political resistance to "death taxes."

• The FAST blocks standard "estate freeze" techniques by taxing gifted assets at sale, not date of donation, and assigning liability to the donor.

• Heirs and trusts of large estates would make annual prepayments of 1 to 5 percent of approximate asset value, which would be consistent with the 16th Amendment.

Chapter Ten: Details and Technical Analysis

• Wealth and MtM taxes are relatively similar when implemented through a retrospective method such as the FAST. An MtM-style FAST would bring in revenue more quickly, however, and for that reason I favor it as the baseline proposal.

• The FAST uses a lifetime $15 million exemption amount, modeled on the Canadian system, rather than taxing individuals based on their net worth. This lifetime approach faces fewer constitutional challenges and is easier to implement when tax is imposed retrospectively.

• To encourage prepayments and mitigate the possibility of large sell-offs of assets before the law goes into effect, the FAST has a transition rule in which prepayments during the first two years after enactment are not subject to any interest charge, and payments can be spread over the next seven years.

• As an anti-abuse rule, dividends and similar payments to related parties are treated as though made to the taxpayer themselves.

• The FAST interest calculations give investors the benefit of full annual deductibility of all losses, but, to deter abusive tax shelters, taxpayers still face standard income tax limits on loss deductions in the year of an actual sale or prepayment election.

Introduction

In 2025, the United States saw the largest transfer of wealth from poor and middle-income households to the rich in recent history (Badger, Parlapiano, and Sanger-Katz 2025; Hacker and Sullivan 2025). The administration's signature tax legislation, the so-called One Big Beautiful Bill Act (OBBBA), hands more than $100,000 to the average household in the top 0.1 percent of incomes, while on average taking about 2.5 percent away from families in the lowest 10 percent of incomes (The Budget Lab at Yale 2025). Taking into account the burden of new tariffs, these lowest-earning families face added costs of more than $2,000 per year (The Budget Lab at Yale 2025). These figures ignore the many other recent upward transfers resulting from massive deregulation and government layoffs which enriched wealthy shareholders at the expense of the average consumer, such as the effective shuttering of the Consumer Financial Protection Bureau.

The OBBBA also punches a hole in the federal budget nearly $3.5 trillion wide. At current short-term borrowing rates of about 4 percent, that is more than $140 billion per year in new interest alone: almost one-quarter of the entire defense budget (Fiscal Data n.d.) and vastly more than the defense budget of any EU member nation. And that relatively low interest rate assumes that global lenders remain confident in the US's ability to pay our debts, despite mounting obligations and an increasing sense that the nation is willing to turn its back on existing promises. Countries that have followed similar fiscal and political paths in recent history, such as Turkey, now grapple with crippling inflation rates of upwards of 70 percent per year.

Wealthy business owners and their heirs in particular made out like bandits in the OBBBA. The Act doubled down on the 2017 tax cuts by further slashing the tax rate paid by owners of businesses that are not publicly traded. It expanded the availability of super-low rates for owners who sell stock of their start-up company. And it left in place popular dodges to help business owners claim federal benefits for the tax they pay to their state. On top of these, the OBBBA amended the estate tax so that families who expected an estate tax exemption of only $14 million in 2026 will instead escape taxation on their first $30 million in inherited wealth. Those with expensive tax lawyers know how to leverage that exemption to shield as much as $300 million or more. All these rules are especially useful to the private equity billionaires who now make up a significant portion of the Cabinet.

What should the next major tax reform look like? Obviously, an important first step will be to reverse many of these damaging changes. But that won't be enough. To fill the fiscal hole the OBBBA dug, we will need more revenue. To stitch back together the thriving economy of 2024, we will need to rebuild government capacity, reinvigorate science and innovation, restart canceled projects to cure cancers, and cool the planet. Perhaps most importantly, we will have to take steps to reverse the toxic political

climate that led to a government of, by, and for billionaires. The mega-rich have profited massively from the early days of the current administration, and so we should look first to them to pay for the cleanup.

Even before the OBBBA was enacted, it was clear that sensible tax reform should start with reforming how we tax the very rich. We are a highly unequal society, perhaps more unequal at the top than since the mid-20th century, and legal constraints on the social and political power of the wealthiest are also as loose as they have been in at least 50 years. Modern innovations in tax avoidance now give families the opportunity to build dynasties that will be (barring future law reforms) permanently free of most tax burdens, enabling these dynasties to hold sway over their corners of the economy in perpetuity. These gross distortions of our traditional notions of a free and fair marketplace of ideas, and the fundamental undermining of norms of equality of opportunity, raise problems far beyond tax policy, but which perhaps can be addressed at least in part through tax reform. Our system is not only fiscally imbalanced, but also a source of deep racial inequity.

This report therefore describes and compares major proposals to reform federal individual income and transfer (that is, estate and gift) taxes, with a focus on how to tax the very richest households, the one-in-one-thousand wealthiest Americans. Prior academic debates about the economics of taxing investments and inheritances have generally proceeded on the assumption that tax rules have to apply the same to everyone, often resulting in at best lukewarm endorsements for taxing savings. I show how transformational it can be to design a set of tax rules that would apply only to the ultrarich. Building on recent social science as well as the evidence accumulating all around us in 2025, I argue that extremely wealthy households derive enormous social power and other benefits from the mere accumulation and holding of wealth, even without spending it. Economists have long acknowledged that if this were true, it would have a significant impact on how we design the tax system, but no other work has played out in detail the logical consequences of that fact.

Designing tax rules for the richest and most powerful is not a new idea. Prior Democratic proposals from Congress and the Biden administration outlined plans for a "minimum income tax" on multimillionaires in which very wealthy households (generally those worth over $100 million) would be taxed on the value of appreciated but unsold property. The administration's proposal was dubbed the Billionaire Minimum Income Tax, or BMIT. Yet some other senators, and commentators outside government, have pointed to possible constitutional limits on that proposal, as well as offering critiques of its economic and political merits.

Critics of the BMIT have proffered a set of alternatives, most of them more limited versions of the same idea. For example, Sen. Mark Warner (D-VA) has proposed that we treat borrowing by very wealthy households with appreciated property as a partial sale

of that property, and a pair of well-regarded academics have written up a more detailed analysis of how that policy might operate (Fox and Liscow 2024). Other commentators suggest that the US reverse its long-standing, but widely criticized, policy of wiping away tax obligations for appreciated property at the death of its owner, which tax mavens call the "basis step-up at death." A bill introduced by the late Congressman Bill Pascrell (D-NJ) would have implemented that idea by treating death as a deemed sale of the decedent's asset. And a third idea, favored by some influential academics such as Natasha Sarin, Larry Summers, Eric Zwick, and Owen Zidar, would be to just raise the capital gains rates imposed on the sale of investment assets (Sarin et al. 2022).

These alternatives also face significant questions about their efficacy, economic appeal, and in some cases even their constitutionality. For example, the proposal to treat borrowing as a deemed sale of the borrower's appreciated assets likely faces the same legal cavils as the BMIT. Recent data also suggest that borrowing represents such a small fraction of the richest households' wealth that it would raise little revenue compared to other options, meaning that it would likely have to be paired with other reforms.

To briefly preview my findings, my central argument is that instead of any of these options, policymakers in search of revenue should adjust the capital gains tax so that its rate increases as the taxpayer holds an asset longer and the asset's value appreciates, which I call the Fair Share Tax, or FAST. The general approach the FAST uses can be employed to implement a variety of reforms. My discussion will focus on a model in which the FAST aims to mirror the revenues and taxpayer incentives of a "mark-to-market" capital gains tax, similar to the BMIT. A mark-to-market, or MtM, tax is just an income tax that includes changes in the value of household assets each year as income. But the FAST is easier to implement, because it doesn't suffer from the traditional challenges tax systems have struggled with when attempting to impose tax at times other than at sale. And there is little doubt that the FAST, which is just a choice of the tax rate, would be constitutional. The FAST can also be used to implement an inheritance tax that would close many of the loopholes in today's estate and gift tax system.

While individual and estate taxes are obviously not the only available sources of new revenue, I will focus primarily on them because they are the key tax levers for any effort to combat the corrosive effects of massive dynastic wealth. I will also discuss, as complements or alternatives, other reforms to the taxation of global enterprises and small businesses. Similarly, I will explain why I view the option of a value-added tax (VAT) or other consumption tax as an inadequate reform on its own, but I fold that discussion into my explanation for why taxing investment gains is so crucial to any meaningful systemic tax reform project.

To set the stage for the discussion, and offer a preview for the impatient, **Chapter One** offers an overview of how the FAST would work. Again, the FAST is an extra charge imposed on sales of assets, but only if the taxpayer has already sold at least $15 million worth of assets during their lifetime. The extra charge is computed through a simple formula that measures the amount the taxpayer has saved, over the life of the asset, by avoiding MtM taxation. Taxpayers can instead simply elect to be taxed on a MtM basis, and there will typically be solid economic and practical reasons for them to do that. Later chapters then explore what the FAST accomplishes and why it is the best legal and economic response to our current moment.

Chapter Two begins that work by setting out the ways in which our current tax system fails to meet the challenge that is inequality today. First, it sets out some facts on the extent of contemporary wealth inequality in the US, and explains that despite some moderate academic controversy about how to measure inequality, there is a broad consensus that the very wealthiest households currently control a larger share of social resources than at most points in modern history.

This massive increase in the fortunes of the fortunate has brought enormous benefits to those who have enjoyed it, and serious harms to the rest of us. Indeed, today the wealthy do not have to spend a dime to enjoy power, prestige, and disproportionate social influence. By controlling media companies, importers, or big employers, they shape our markets and the marketplace for ideas. I argue that social science evidence now strongly supports the inference that the ultrarich get vast utility just from ownership—what economists sometimes call "wealth in the utility function." Social science also offers a mountain of evidence that these kinds of accumulations damage societies in several crucial ways, from slowing growth to speeding inflation to demoralizing and discouraging young entrepreneurs and innovators.

There is, in short, a compelling case for tax policy that lasers in specifically at the ultrarich. Some commentators have argued that recent left-leaning tax policy has neglected the revenue potential and other merits of taxing the relatively comfortable professional class, the top 10 percent or so of earners. There is merit to these arguments, but the evidence I survey also makes a case that the ultrarich are unique in the opportunities they control and pass on to their children, and that the resulting damage they do warrants a focused response. The children of professional parents might be born with a better chance of choosing what college to attend; the children of a media dynasty are born with a better chance of choosing the next president.

Chapter Three explains how we got here and our limited options for getting somewhere else. It begins with background on how the current income and transfer (estate and gift) taxes try but often fail to reach accumulated wealth. For both, the problem is in large measure that a small but important share of assets are hard to value. In the income tax, our response to the valuation problem is to include gains or losses in

taxable income only when the taxpayer sells (or otherwise disposes of) an asset. This is called the "realization" principle. While administratively convenient, taxing only at realization means that individuals who make most of their money through investments get to choose when to pay tax. Because of the basis step-up at death rule, one of these options is "never." The result is evident in recent news stories reporting that many of America's wealthiest individuals, such as Jeff Bezos, have reported taxable incomes lower than those of the IRS agents who audit them.[1] The realization principle in turn drives many governments to impose low rates on investment earnings, with the obvious result that wealthy investors tend to pay lower income tax rates than middle-class salary earners.

The chapter then builds on this background to explain the potential appeal of taxing wealth directly, instead of waiting for it to be "realized." Traditional wealth taxes collect a set percentage of a household's net worth—or, often, a subset of their net worth, such as the value of their home or their publicly traded stock. An MtM tax is similar in many respects to a wealth tax, though the two differ in some details I explore more in a later chapter. Both approaches can minimize the damaging economic distortions caused by the realization principle, such as the incentive to hold even underperforming assets indefinitely, sometimes known as the "lock-in" problem. And of course both prevent the situation in which wealthy investors pay lower rates than middle-class workers.

Broad-based wealth taxes, which were once common in the US, floundered by early in the 20th century because of valuation problems, but Chapter Three considers other global experiences to argue that innovations in tax system design have made wealth and MtM approaches more viable. For example, the Swiss wealth tax collects more than 1 percent of GDP in revenue, and a newly revamped Spanish wealth tax has also performed respectably, both on the back of a "formulaic" method for appraising small business using the earnings and assets reported on financial statements.

The biggest challenge to a broad-based wealth or MtM tax in the US is thus not necessarily practical, but rather constitutional. In May 2024 the Supreme Court decided *Moore v. United States*, a case ostensibly about whether a narrow MtM tax of certain foreign business holdings was within the 16th Amendment definition of "income." Though the government won, the Court pointedly declined to bless all MtM taxes. While the government would have many strong arguments in a potential future challenge to a more comprehensive MtM or wealth tax, some commentators fear that a conservative Court would be willing to reach for creative ways to strike that tax down.

[1] *See* Eisinger, Ernsthausen, Kiel (2021) (reporting, for example, that Jeff Bezos paid an effective tax rate of only 1.1 percent on his true income across 2006 through 2018 and that he paid zero income tax in some of those years and "he even claimed and received a $4,000 tax credit for his children" in 2011 because he "filed a tax return reporting he lost money," and also that in "both 2016 and 2017, investor Carl Icahn, who ranks as the 40th-wealthiest American on the Forbes list, paid no federal income taxes").

It is possible the Supreme Court will extend *Moore* to make it difficult to tax appreciated assets at times other than when they are sold.

In the past, influential commentators have argued that it is actually good that tax systems struggle to reach the investment returns of the wealthy, because economic theory holds that it is inefficient to tax most savings (Adam et al. 2011; Auerbach 2006). **Chapter Four** therefore shifts focus from the legal to the economic, considering whether we should be taxing investment earnings at all, or whether instead we should be moving more toward some form of tax on consumption. In the older view, taxing savings is unwise because it distorts a household's choice about whether to spend money today or tomorrow, as future spending is taxed more heavily, and indeed over generational lengths of time the effective tax rate may approach 100 percent.

Over the last decade and a half, economic consensus has shifted back toward taxing investment income. Investment income is a "tag," or reliable marker, of a household's ability to pay. Taxes on investments can also be an effective response to taxpayer efforts to conceal their labor income or recharacterize it as earned through investments. Some economists have further argued that even if taxing investments and inheritances changes the time when households choose to spend their money, that change is good because it encourages productivity.

In addition to supporting a tax on savings, modern economic theory suggests that taxing the investment returns of the extremely wealthy would be especially efficient. Economists strongly favor taxes on public bads such as carbon, and Chapter Two lays out several ways in which highly concentrated wealth damages a society. The ultrarich may also have the power to control their own future tax rate, and knowing that a tax "holiday" could someday be in their future, may be overly inclined to accumulate wealth until that future date. Massive fortunes might further reduce effort and entrepreneurial spirit, as Andrew Carnegie famously argued. While fortunes can also help underwrite entrepreneurship, the marginal benefit of a slightly more enormous fortune is unlikely to offset the Carnegie effect. Taxing massive piles of wealth and their investment returns would be a way of mitigating both of these negative economic effects.

Chapter Five continues this line of inquiry by asking whether a tax system that omits any tax on investment income—commonly called a "consumption tax"—could really achieve its key goals. My main argument is that economists who favor consumption taxes have mostly never tried to draft one, and so have failed to appreciate the very significant legal constraints, including US constitutional limits, that a real-world consumption tax would have to confront.

There are three major variations on a consumption tax, and each has its own trade-offs. One is the VAT, exotic to Americans but familiar to consumers around the world. Obviously a VAT, national sales tax, or tariff is regressive, to the point where

proponents like Michael Graetz would set aside a large chunk of their revenues to offer a cash refund to low-income households (2008). And because the very wealthy spend only a small share of their wealth during their lifetimes, a VAT is not an effective tool for addressing top-end inequality. This limited reach and revenue potential isn't necessarily disqualifying, but instead suggests that the Graetz proposal works best if paired with other reforms that fill its gaps. In particular, in a world where massive wealth accumulation itself delivers consumption benefits that a VAT could not reach, the existence of a VAT might imply additional taxes aimed at wealth accumulation, if for no other reason than to offset the VAT-favored status of consumption from wealth accumulation.

The wage tax, which features centrally in proposals from Bradford (2005) and Carroll and Viard (2012), aims to resolve the regressivity of a VAT by implementing a consumption tax through the traditional income tax. As the name implies, the wage tax gets from the income tax to a consumption tax by excluding savings. In practice, though, this is much more difficult than it sounds, as to omit savings we have to be able to distinguish it legally from alternatives, such as payment for services rendered. Yet the legal system already struggles mightily with this question in settings where the dollars at stake are generally much lower than they would be if investments were fully exempt. Famous examples include the "carried interest" of private equity managers, the share of partnership profits set aside to compensate their efforts, as well as the payroll-tax loophole for self-employed business owners. While there may be some ways to draft a wage tax to combat these avoidance strategies, many of the most promising routes would require the tax system to presumptively treat investment gains as "income" before sale, which is exactly the practice that the *Moore* case suggests may be impermissible under the 16th Amendment.

Another major consumption tax variant, a cash flow consumption tax (CFCT) similarly runs into legal-design constraints and constitutional worries. A CFCT is an income tax, but with a deduction for savings and debt repayment and an income inclusion for selling investments and new borrowing. It's crucial for a CFCT that taxpayers do not get deductions when they acquire assets that have consumption value, yet in a world where massive asset accumulations supply power and prestige, that is very hard to accomplish. The best a CFCT designer could do would be to impose a tax on the "imputed income" (that is, the economic benefits other than cash) owners get from ownership of their properties. Unfortunately, such a tax faces the same constitutional obstacles under *Moore* as a wealth tax. It also is uncertain whether it would be constitutional to tax new borrowing.

Chapter Six then considers whether arguments about investment income are different for inherited property. For the most part, the case for taxing massive accumulations of inherited wealth is even stronger than for taxing them during the accumulator's lifetime. To the extent that some bequests are accidental, rather than deliberate and

planned, the case for a very high tax on those transfers is quite strong: If we taxed people who found money on the street, it is very unlikely that people who drop their wallets would plan to minimize that tax. Many large bequests may be accidental in this way if the living accumulate wealth for the power and prestige it can deliver, rather than in order to spend it.

Some influential commentary has argued that we should subsidize gifts and bequests, rather than taxing them, but these arguments are unpersuasive when what is being transferred is disproportionate power and influence, rather than, say, a nice watch. Inherited social control demoralizes the large majority of households who don't have it, and can slow economic growth, as well. And of course rich heirs, like their rich parents, likely have more money than they can readily spend.

Unfortunately, the US estate and gift tax system is broken, and most existing proposals to reform inheritances likely won't work well, either. An owner's death doesn't give us new information about their property's worth. Over time, tax advisers have learned how to exploit this information gap with an arsenal of legal tricks that give inherited property a misleadingly low apparent valuation. Similarly, wealth consultants have learned to leverage trust law, once a sleepy and obscure area, to permanently exempt vast inherited fortunes from transfer tax, and in the case of certain family businesses from essentially all tax on the owners. Safeguard mechanisms that were supposed to prevent this result, including the gift tax and the generation-skipping transfer tax, have failed, and now actually help to eliminate tax. Trusts that are perpetually exempt from all transfer taxes now hold more than $5 trillion in assets (Galle, Gamage, and Lord 2025).

Similarly, although there is an obvious case for taxing untaxed gains when the investor dies, most efforts to treat death as a realization event or deemed sale have failed to grapple with the lessons of the Canadian experience, where for 40 years death has been treated as a sale. As best I can tell, Canada's system has not reached the wealthiest Canadians, because of tax planning techniques such as the "freeze" transaction, which is also popular in the US as a means of avoiding the estate tax.

Chapter Seven then turns from this series of critiques of existing proposals to set out a path toward legal and workable reforms, starting with an overview of "retrospective" taxation. I first explain the first generation of retrospective proposals, from the economists Alan Auerbach and David Bradford (2004). In the Auerbach-Bradford retrospective tax, the government waits until an asset is sold to impose capital gains tax, but adds an interest charge to account for the time value of money. This was the approach of Sen. Ron Wyden's (D-OR) Billionaire Income Tax (BIT). The interest charge helps to offset the lock-in problem, because taxpayers have less to gain from deferring tax. And of course by waiting until the asset is actually sold, the Auerbach-Bradford method makes it easier to know what that asset is worth, and makes it more likely that

the taxpayer will have cash available to pay (though not certain, particularly if the interest rate is high).

A key problem for retrospective taxes is how to set the interest rate. Auerbach and Bradford, for example, proposed an elegant method for setting the rate at exactly the risk-free rate of return taxpayers could earn in the economy over the period they held their asset. One difficulty with their method is that most rich people who became rich (i.e., who didn't just inherit their money) got that way because they took risky bets and won, or otherwise have access to market-beating investments, such as monopoly patent rights. Investors who can effectively borrow from the government at the risk-free rate, and expect to earn several multiples of that rate with the borrowed funds, are not very likely to cut short the loan term by selling the underlying asset.

With two coauthors, David Gamage and Darien Shanske, I have previously set out a refinement to retrospective tax that solves the rate and liquidity problems, among others (Galle, Gamage, and Shanske 2023). To simplify a bit, whenever a taxpayer seeks to defer their tax obligation on an asset, as under a realization-based tax system, the government gets a percentage stake in the asset, instead of a fixed tax bill plus an annual interest percentage. Algebraically, though, the percentage stake turns out to be the same as if the government were collecting its usual tax, and then adding an interest charge that is the asset's own internal rate of return. The method is therefore time-neutral: The taxpayer can't do better, or worse, by selling faster or slower. And the method ensures the taxpayer will never owe more than the value of the asset. That was the method deployed for certain electing taxpayers in Rep. Steve Cohen's (D-TN) bill implementing President Biden's BMIT proposal, which otherwise imposed MtM taxation on individuals worth more than $100 million (and which, by way of full disclosure, was drafted by me, Gamage, Shanske, and other smarter collaborators).

Chapter Eight then explains how and why we might use retrospective taxation to replace the BMIT or other broad-based MtM tax. Again, one of the uses of retrospective taxation is that it resolves valuation and liquidity concerns with taxation before sale. Some surveys also suggest the voting public dislikes, or at least misunderstands, taxing unrealized gain. Retrospective taxation with an economically-accurate interest charge (eventually) gives the government the exact same revenue and progressivity as an MtM tax, but imposes tax at a time—sale of the asset—some members of the public seem to find more intuitive.

Crucially, retrospective taxation also avoids any plausible constitutional objections to a wealth or MtM tax. The argument that petitioners pressed in the *Moore* case—and which the Court sidestepped without resolving—was that the term "income" in the 16th Amendment does not encompass unrealized gains on property prior to sale. That question is irrelevant to a retrospective tax, because retrospective taxes are in fact imposed only on realized gains. What distinguishes a retrospective system from plain

old capital gains is the tax *rate*, which typically gets higher the longer the taxpayer holds the asset. But varying the tax rate with the holding period of an asset is already a long-standing and totally uncontroversial feature of the federal tax system, dating back to 1921.

Although a version of the BMIT that was introduced in Congress allowed many taxpayers to opt for retrospective taxation, a better framing would instead be to impose the retrospective tax on its own, but allow taxpayers who want to opt out to pay tax before sale. Critics of the BMIT generally ignored the optional deferral sections, focusing instead on the supposed valuation and liquidity problems of a standard MtM tax. So, too, are the intuitions of voters and Supreme Court justices likely very different for a tax that occurs at sale, with an option to pay sooner, rather than the other way around. Certain anti-abuse rules could also require prepayment for taxpayers who take steps that might frustrate later collection efforts. The terms available to taxpayers who opt out could be made relatively attractive (albeit less favorable than the current free and indefinite deferral regime), so that in combination with the anti-abuse rules we might still expect much of the revenue from the reform to be scored within a 10-year budget window.[2] This is the core of the FAST proposal.

Letting taxpayers delay their tax payment indefinitely does come with some political-economy concerns, highlighted most effectively in earlier work by Gamage and his co-author John Brooks. The chapter notes the difficult trade-off between political economy and constitutional law these reforms may face. While narrow anti-abuse rules might trigger tax before sale, the overall system likely has to rely on voluntary taxpayer payments in order to accelerate tax collection. I argue that offering incentives for taxpayers to prepay their FAST liability is fully consistent with *Moore*, and can be implemented such that assets will be valued fairly even though we might lack the direct value evidence a sale would provide.

Auerbach and Bradford conceived of retrospective taxation as an income tax tool, but **Chapter Nine** explores how the same idea can plug holes in the proposals to reform the intergenerational transfers I identify in Chapter Six. Using these techniques, we can both continue FAST liability for heirs, and also impose an additional 40 percent government share on inherited wealth in excess of $15 million. Instead of taxing at death, a retrospective wealth transfer tax taxes heirs at the time they sell their inherited assets, similar to older proposals for "carryover basis" at death. Like those proposals, the retrospective approach dodges both the practical problem of playing cat-and-mouse with taxpayer valuation games, as well as the political problem that

[2] Because the retrospective tax is time-neutral, it should also increase revenue by increasing the share of built-in gains that are realized within the budget window, relative to existing policy. The extent of the "lock-in" effect is uncertain; Agersnap and Zidar (2021) suggest it is smaller than most previous measures. I offer some caveats to the Agersnap and Zidar findings. In any event, Congressional Budget Office and Joint Committee on Taxation (JCT) revenue estimates generally employ the large elasticities of earlier papers, suggesting that the revenue effects of removing lock-in could be large.

voters seem to detest "death taxes." Unlike carryover basis, though, the retrospective approach can charge an economically-accurate rate of interest on the value of tax deferral, discouraging heirs from holding their inheritance until their own death (and, potentially, debt-financing their consumption in the meantime). An inheritance tax system can also constitutionally require taxpayers to make advance down payments against their ultimate liability, a step that is desirable for budget scoring as well as to reduce the risks of tax avoidance and counter-reform.

The retrospective approach also can counter freeze techniques. The standard freeze involves a transaction in which the wealthy taxpayer transfers the asset to another person or entity who is not subject to the wealth transfer tax, at least not for many more years. Usually this transaction is itself taxed in one way or another, either because it is treated as a sale or because it is subject to gift tax. But the taxpayer can readily structure the transaction so that the tax system's valuation of the transferred asset is much lower than it will be when it passes to the next generation. Obscure-sounding but routine (to mega-millionaires) structures such as the grantor-retained annuity trust and the intentionally defective grantor trust are usually the key building blocks of those strategies. We can instead make the transferor liable under a retrospective tax, again with an economically accurate interest charge, when the transferee disposes of the asset.

Any meaningful reform of intergenerational-transfer tax also needs to fix the taxation of trusts. A key anti-abuse rule, the "generation-skipping transfer," or GST, tax, was badly designed and complex—it is still complex but now mostly decorative. Because of the GST's flaws, it's likely that more than $5 trillion is now held in trusts that are totally and perpetually exempt from estate tax. There are a few routes to closing up these gaps, such as by making trusts subject to the same retrospective-type tax that other heirs would face under my proposal, or by imposing a small up-front tax on assets held by GST-exempt trusts. Again, it is preferable to bring in tax revenue sooner rather than later, so I favor the up-front tax, creditable against any estate or GST liability the trust or its beneficiaries do actually incur. There are no constitutional barriers to that approach for a tax on business entities such as trusts.

Finally, **Chapter Ten** explores some of the more technical design choices for the FAST. Many of these will mostly be of interest to legislative drafters and tax lawyers, if anyone. My goal, though, is to be transparent about the many hard decisions that a tax system of this ambition must make, especially if it is aimed at a group of taxpayers who will have access to the best tax advisers money can buy. Again, Chapter Five underlines how difficult the fundamental legal questions are in this space. As tax lawyer Ed Kleinbard argued, many past tax reform proposals have not been drafted to the level of specificity that would let us see how feasible they would be if ever brought to Congress (2016).

Maybe the most interesting section of Chapter Ten for the general reader is its longest, addressing whether the FAST should be modeled to recreate the economic effects of a wealth tax, or instead an MtM income tax. In a sense, a wealth tax is just an income tax under the assumption that everyone earns about the average rate of return in the economy. That makes it much simpler than an MtM tax, which has to measure each household's actual returns, but also may shift some risk onto taxpayers. Collecting tax retrospectively mutes these differences, since over time each household's returns are likely to converge toward the average. Ultimately, I favor an MtM model for the FAST not because of economic or administrative differences, but because it likely would bring in money more quickly, improving its 10-year budget score and reducing the risk that opponents would try to repeal it before their payments are due.

In short, the FAST is a tax for our particular political, economic, and constitutional moment. It taxes concentrations of extreme wealth, and obliges the ultrarich to pay more the longer they enjoy the power and status their wealth enables, or if they unfairly inherited a power that few others in society can exercise. If drafters weren't so constrained by the US constitution, quite possibly the FAST would look different, and might tax many assets each year as they gain value, as the BMIT did. But with that avenue likely closed, the FAST might be the best available way to tax the rich.

Chapter One: A FAST Overview

• The FAST gives the government a 23.8 percent claim on all untaxed appreciation in excess of $15 million per household, payable at sale or other disposition of an asset. This claim yields the same government revenue as an annual 23.8 percent tax on gains plus interest at the internal rate of return of each asset.

• Taxpayers can elect to prepay tax liability to eliminate additional interest charges on existing built-in gains. Assets are valued at prepayment under terms favorable to the government.

• Certain tax-avoiding transactions, such as income stripping payments, also trigger tax before sale.

• FAST liability stays with gift-givers during their life, and transfers to heirs at death.

Most of this report will be an argument that builds toward the case for the FAST. Some readers may want a better sense of where we are going before they begin the journey. This chapter offers key details about the workings of the FAST.

Viewed from a distance, the FAST is a tax on investment assets (and certain forms of deferred compensation) held by people and trusts in which the ultimate tax rate typically rises the longer the investor has held the asset. The tax generally isn't imposed until the asset is sold, but there are a few situations in which owners have to make down payments against their ultimate tax liability. Property owners can also opt to pay in advance, but to do so they will usually have to accept the government's valuation of their assets. Gifts do not shift liability for the tax, but accumulated tax liabilities carry over to heirs. These rules would only apply to extremely wealthy households.

Zooming in a bit more, the FAST gives the government the same tax revenue, in present-value terms, as it would have received under a tax that was imposed annually, but collects that money only at sale. Although different versions of a FAST are possible (and explored more in Chapter Ten), the base proposal is for the FAST to approximate the cash flows and incentives of an MtM income tax, which is to say a tax in which gains and losses are taxed each year regardless of whether an asset is sold. The key difference between an MtM tax and an annual wealth tax is that an MtM tax takes account of a property owner's basis, a tax accounting concept that usually measures how much the owner initially paid.

Thus, my proposed version of the FAST would replicate the revenues of an annual MtM tax. When a taxpayer sells an asset, they compute what their payments each year would have been if the asset had been subject to MtM treatment. Their tax bill at the time of sale is then the payment that would leave them with the amount they would have had remaining if they had paid their MtM bill each year. Luckily, as Kaplow (1994) and Land (1996) show, these computations can all be collapsed into one simple equation, in which the taxpayer only needs to know their purchase price, the sale price of the asset, and the tax rate.[3] For purposes of any interim tax payments that are triggered before sale—more on those momentarily—the government will be treated as being entitled to 11.9 percent of the sale proceeds of the asset and increasing its stake by a fixed annual amount each year, such as 1 percent.[4] Again, my proposal is for an MtM-type tax, but the calculation is even simpler for a tax that is intended to recapture the revenues of an annual wealth tax.[5]

Example 1.1: FAST Mirrors Cash Flow of an MtM Income Tax

Effie, a member of the Exemplar family, owns all of the outstanding stock in Exemplar, Inc., with a year one value of $100 million. Effie purchased the stock in year zero for $95.24 million. In year two, when Effie sells her stock, the value of Exemplar, Inc. stock is $105 million.

Scenario One: There is an MtM tax in effect with a 20 percent rate. In year one, Effie owes $0.95 million in income tax ($4.76 million in gains × 20 percent). Effie

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[3] The formula is: tax due = $S_p(1 - (S_p/P)^{-t})$ where S_p is the pre-tax sales price, P is the asset's basis, and t is the (absolute value of the) applicable tax rate. In effect, the formula is calculating what the annual after-tax return on the asset would have been, and thus what its value at the time of sale would be under continuous compounding. The difference between this value and the actual sale price is the amount the taxpayer has saved through deferral, and is thus the amount the tax system should charge to make the investor indifferent between selling and keeping the asset in any given year. If tax rates change over the period the individual holds the asset, the applicable tax rate is the year-weighted average of the rates during the holding period.

[4] That number doesn't have to be chosen arbitrarily: 1 percent is the tax rate on capital gains (23.8 percent) times the average untaxed appreciation in investment assets (50 to 60 percent) times an average return of around 8 percent. The exact value could be adjusted as these parameters change.

[5] If the FAST were intended to approximate the structure of a wealth tax, it might impose, say, a 2 percent claim on the sale proceeds for each year that an asset is held. For instance, imagine that Effie buys stock for $1 million and sells it 10 years later for $100 million. She would owe the government tax of 10 × 2 percent × $100 million, about $20 million. If the stock didn't change price at all, she would owe only $200,000. In later years, the government's added stake would actually be a bit less than 2 percent. Each year, the government would get 2 percent of the share of the value it doesn't already have a claim against. So in year two, it would get an additional 2 percent × (100-2 = 98 percent) = 1.96 percent stake, for a 3.96 percent total. To emphasize, this would not be actual government ownership of the asset, but instead only a claim against the taxpayer's eventual sale proceeds.

does not have cash available to pay and borrows $0.95 million from a commercial lender at a 5 percent annual rate, with interest and principal payments deferred until year two.

Scenario Two: An MtM-model FAST is in effect with a 20 percent rate. In year one, Effie owes $0 tax. In year two, Effie will owe tax in the amount of 20 percent of the gain in value of the Exemplar, Inc. stock she sold, plus an adjustment for appreciation.

Results

Under Scenario One, Effie will pay $1 million ($0.95 million principal plus about $0.05 million interest) in year two to her lender, and $1 million in tax ($5 million in year two gains × 20 percent). After tax, principal payments, and interest, Effie nets $103 million.[6] Assuming the government invests her year one tax payment and earns a 5 percent return, in year two the government will have $2 million in revenue.

Under Scenario Two, Effie will pay $105 million × (1 − ($105 million/$95.24 million)$^{-0.2}$) = $2 million in tax. This formula calculates the amount Effie is obliged to pay in order to leave her with an after-tax return equal to the amount she would have been left with, in year two, under a pure MtM tax. As we have just seen, that amount is $103 million. The government will have $2 million in revenue in year two.

This rate structure ensures that taxpayers generally cannot gain any economic advantage by holding onto property and deferring tax. Indeed, FAST produces the same government revenue, at the time of sale, as if the government had imposed an MtM tax, but lent Effie the money to pay her tax, and then charged her interest at a rate equal to the internal rate of return (IRR) of her investment. By charging interest at the asset's own IRR, the FAST helps ensure that Effie is indifferent about when she sells. Suppose that she pays today by selling off a portion of the taxed asset, which causes her to give up a stream of future returns on that portion. That stream of future returns is exactly equal to the extra interest charge the FAST imposes. Either way, Effie's payment is the same.

[6] For simplicity and ease of reading, in this example and others to follow, I generally present results as if interest and other returns were compounded annually, rather than the continuous compounding that is usually applied to financial instruments. With continuous compounding, Ellie would actually owe $.97 million in year one tax.

The intuition behind the FAST is that tax systems should be, as Ed Kleinbard argues, "progressive in time" (2016). Again, the FAST effectively imposes an interest charge on taxpayers who retain their assets as they appreciate. Holding assets in order to delay tax on their sale is a luxury most families cannot afford, so that the FAST is a form of luxury tax. By increasing its tax burden with time, the FAST also effectively taxes the ongoing exercise of power and prestige that comes with vast accumulations of wealth.

Interim and Opt-Out Payments

Although the FAST generally is not collected until taxpayers sell their investments (or collect their deferred compensation), there are several situations where some tax is paid sooner. First, taxpayers who withdraw money from a property that is subject to the FAST will typically have to make an interim payment, equal to the government's deemed ownership percentage times the amount of the withdrawal.[7] That payment reduces tax liability owed at sale. Payments to related parties also count as a taxable withdrawal.

Rules for these kinds of interim tax amounts are needed because otherwise it would be relatively easy to consume investment assets without paying the FAST. For example, imagine that Effie owns a business with $100 million in assets. She might liquidate these assets and cause the firm to distribute the resulting cash to herself as a dividend, leaving the firm with nothing. She might then sell the stock of her company for $1, leaving her with no FAST liability at sale.[8]

In addition to these mandatory interim payments, the FAST should also offer taxpayers the choice to voluntarily pay tax before they sell, as we do now with the tax on Passive

[7] The deemed ownership percentage begins at 11.9 percent and increases by 1 percent of the remaining non-government share each year (e.g., in year two, the increase is 1 percent of 88.1 percent). In some cases these payments would otherwise be taxable to the distributee, such as in the case of a distribution taxed as a dividend under Section 301, or payments of salary to a business owner. How to adjust the FAST interim tax amount to reflect these other tax payments would depend on the exact aims of the FAST policymakers. For instance, a FAST intended to replicate the economics of a wealth tax would likely not reduce the interim payments by the amount of income tax paid, while one intended to more closely approximate an MtM income tax likely would.

[8] A FAST implemented with a retrospective true-up formula would include dividends in the final sale price, so this basic asset-stripping technique would be ineffective. But prepayments are still advisable under a true-up system because they help to mitigate political optionality. That is, a taxpayer might strip value out of an asset subject to FAST liability and then lobby to repeal FAST to avoid the true-up.

Foreign Investment Companies (PFICs).[9] Typically, taxpayers have taken the government's shirt in these kinds of optional prepayment regimes, because their ability to control the timing and appraised amount of the tax payment gives them an overwhelming advantage. The gift tax regime is a standard example here (Galle, Gamage, and Lord 2025). The PFIC regime is something of an exception, because there is a hefty penalty rate imposed on taxpayers who wait until sale to pay, and because the underlying asset is usually a publicly traded but non-US equity interest that is easy to value.

As Chapter Eight explores in more detail, giving taxpayers the choice about when to prepay offers a powerful inducement to do so, and in some senses might be too generous. To level the playing field, optional prepayments should be on fairly favorable terms to the government. In particular, for non-traded assets, the FAST rules would provide a set of valuation rules that taxpayers would have to accept in order to successfully opt out of later FAST liability, including accepting the appraised value offered by a government-chosen appraiser where necessary. To satisfy the Due Process Clause, taxpayers would still have a somewhat constrained ability to appeal these valuation determinations, with judicial review under a standard that gives significant deference to the government valuation estimate. Nonetheless, many taxpayers would likely accept this bargain in order to escape the steady accumulation of interest-like tax charges, as they mostly do under the PFIC regime.

Opt-outs would not eliminate tax liability for any future appreciation, but instead only cut off interest-like tax rate hikes for prior years' liabilities. That is, when the taxpayer elects MtM treatment for a given year, they pay tax as if they had sold everything, and will get a basis step-up to the sale price. If they don't make that election in later years, the extra charge imposed at sale by the FAST will be based on the rate of growth of the asset in the years between sale and when they last made the opt-out election.

In essence, taxpayers would be choosing each year whether to pay tax on their annual investment gains, or instead to defer the tax but pay a higher tax rate at sale. Because the tax rate at sale will reflect the asset's own rate of growth, there is little to gain for the taxpayer in opting to defer, unless they believe that the government's valuation

[9] The PFIC rules are part of a suite of special provisions dealing with the taxation of US owners of non-US entities. Absent some special rule, the profits or losses of the non-US entity would not affect the US owner's taxable income until the entity paid dividends or the owner sold a portion of their equity interest. The PFIC regime imposes a surcharge on owners of "passive" entities that primarily hold investment assets, with the charge being imposed at the time the owner receives such dividends or sales proceeds. The charge is intended to approximate the deferral benefits the owner enjoyed from avoiding tax in earlier periods, but is often described by tax advisers as "punitive" or "burdensome." At their election, a taxpayer who owns an interest in a qualifying PFIC can be taxed on an MtM basis for their proportional share of the realized income of the investment company, thereby avoiding the surcharge.

method would for some reason greatly over-value the asset.[10] Taxpayers have to opt for either prepayment or deferral for all assets in a given year.

Example 1.2: FAST and Optional Prepayment

Effie owns all of the outstanding stock in Exemplar, Inc., with a year one value of $100 million. In year 10, when Effie sells her stock, the value of Exemplar, Inc. stock is $150 million. A wealth-type FAST is in effect with a 2 percent rate.

Scenario One: Effie elects to prepay this liability, funding it with a sale of Exemplar, Inc. stock. In year one, she owes $2 million in wealth tax, leaving her with $98 million in stock.

Scenario Two: Effie does not make the prepayment election. In year one, she owes $0 tax. In year 10, Effie will owe tax in the amount of 2 percent of the value of Exemplar, Inc. stock she sold.

Results

Scenario One: In year 10, Effie holds $147 million of Exemplar stock ($98 million plus appreciation at a compound rate of 5 percent per year for 10 years). Because she elected to prepay, she owes no additional tax at sale, leaving her with $147 million.

Scenario Two: Effie pays $3 million tax in year 10 (2 percent of $150 million), also leaving her with $147 million.

Gifts and Bequests

Transfers of assets should not reduce FAST liability. In the case of gifts, tax liability stays with the donor, though as detailed in Chapter Ten special rules will facilitate contractual arrangements in which the donee is required to reimburse the donor for their tax cost if the duo so choose. For inherited property there of course is no longer a donor around to tax, and so the FAST account simply transfers to the heirs. That is, if

[10] In part, this claim depends on whether the FAST allows taxpayers to make the prepayment election asset by asset, or whether they must elect one regime for all their property. As drafted, the FAST requires one regime. If the election is instead asset-by-asset, conceivably taxpayers could arbitrage the interest charge to some degree. For instance, taxpayers might choose to defer the assets in their portfolio with low expected growth, and use the resulting tax savings to invest in higher growth (but likely riskier) assets. If the high risk assets pay off, this strategy adds tax advantages to the winning bet. If policymakers allow asset-by-asset elections, the interim payment rules should be adjusted to tax transfers of value between entities owned by the taxpayer, as otherwise such transfers could be used as part of an arbitrage strategy.

Effie leaves her stock to her daughter Edie, Edie will pay the exact same amount of tax when Edie sells as Effie would have if it had been Effie who made the sale. As under current law, death would not trigger any immediate tax.

This combination of rules somewhat resembles, with some key improvements, the "carryover basis" regime that Congress has twice enacted but twice repealed. In those regimes, families were able to defer tax from the time of inheritance until the time of a later sale of the inherited assets, and possibly indefinitely. In contrast, the FAST would increase the tax due at later sale to capture all of this deferral benefit, making it unprofitable for families to delay. Carryover regimes also are vulnerable to income stripping, or transfers of value out of inherited businesses into other entities that are not subject to a tax overhang. The interim payment rules of the FAST should mitigate taxpayer efforts to strip value, through dividends or other payments to related parties, out of assets with large potential tax liability.

Taxpayers who receive transferred FAST liability in this way would always have the option to prepay, as with other FAST liabilities. Again, this prepayment would settle the government's existing claim on future sale proceeds, but would not prevent additional claims from accumulating if the taxpayer continued to hold the asset in the future.

As Chapter Nine argues, the FAST should also include an extra bracket at the top for vast inherited wealth. Each person who receives total gifts and bequests in excess of $15 million (the current estate tax exemption amount) would take those assets subject to an additional 40 percent government interest in the ultimate sale proceeds of those assets. A similar rule would apply to large accumulations of wealth held in trust. Further, taxpayers who get FAST properties through bequest, as well as trusts, would have special interim payment obligations that other taxpayers would not. These annual payments could be set small enough that they would not pose any significant liquidity concerns. For administrative ease, the payment could be the amount by which the government's claim on sale proceeds increases, as this would typically be 1 to 2 percent of estimated asset value each year. As Chapter Nine explains, it is constitutional to impose annual payments on taxpayers who receive wealth transfers, even if it would not be constitutional to impose annual payments on others. Since it is preferable to collect revenue as soon as possible, policymakers should make use of this legal flexibility to defer a smaller portion of the tax on gifts for rich heirs.

Who and What Is Taxed?

The FAST would be part of the income tax and would follow income tax rules unless otherwise specified. For example, the first $500,000 in gains from the sale of a personal residence would not be taxed. Wash-sale rules would prevent taxpayers from deducting losses on a property they sold and immediately replaced with a comparable asset.

The FAST would not need to apply to most taxpayers. While many different approaches to an exemption and filing threshold are possible, the base proposal would be to exempt a household's first $15 million in lifetime gains from FAST liability. That is, sellers would still owe capital gains tax on investments sold for profit, but would not owe the extra FAST taxes until they had reported at least $15 million in gains over their lifetime. To facilitate auditing, households with roughly estimated gross assets of more than $5 million would have annual reporting obligations.

Certain kinds of assets, such as partnership profits interests and assets held in "supplemental executive retirement plans" would have to be covered by the FAST even if the owner would not otherwise be subject to it. These kinds of properties are common for private equity managers and CEOs. Under current law, the income tax system usually ignores them until many years after they are earned, due to a supposed difficulty in estimating their value, giving the holders a large deferral benefit for no good policy reason. Mandatory FAST treatment would overcome this problem. To make sure that wealthy private equity managers whose worth is mostly tied up in these kinds of future interests do not escape FAST treatment for their other holdings, the FAST cutoff amount would also have to include a simplified measure of the value of these future interests, such as the current value of the underlying assets (maybe minus a small discount because of the chance the future interest does not pay off, as when a manager only earns a payout when they exceed a "hurdle" return).

Similarly, the FAST is also a convenient way to account for certain other transactions with uncertain future payoffs. A classic example are so-called variable prepaid forward contracts, which are essentially a form of nonrecourse borrowing used by corporate executives. Treasury and IRS should be able to designate those or other transactions for mandatory treatment under the FAST rules, where that would aid in the administration of the tax system and produce more equitable results.

Transition Rules

There is no special rule for applying the FAST to assets whose value may have accumulated prior to the effective date of the bill. To mitigate any potential unfairness of charging "interest" on tax payments prior to the effective date, and to reduce incentives to sell off assets before the bill goes into effect, there would be a special rule for voluntary prepayments in the first two years after enactment. Electing taxpayers during these two years can get a basis step-up by paying accumulated capital gains, without having to pay an additional FAST charge. Payment of the resulting tax bill can be spread over the next seven years. As a result, taxpayers with highly-appreciated property at the date of enactment will have strong incentives to elect prepayment, suggesting that most existing unrealized gains will be taxed within the 10-year budget window.

Chapter Two: The Problem of Top-End Inequality

• The richest 340,000 Americans own $1 in every $6 of private US wealth, in a nation of more than 340 million. The fortunes of these lucky few have grown three to four times faster than even other relatively well-off households over the past four decades.

• Highly concentrated wealth at these levels damages the mental and economic well-being of most everyone else. Highly unequal economies grow more slowly, suffer more crises, and experience higher inflation.

• Vast wealth offers unique benefits to owners that few others can enjoy, even if that wealth is never spent. Social science data now let us get a rough measure of the political and social power, and resulting personal satisfaction, that wealth brings.

• Wealth enables power and influence through direct control of information, supply chains, and jobs, as well as derivatively through promises to use that control to benefit others in exchange for favors. Even philanthropic wealth offers its controllers similar benefits.

This chapter sets the stage for the others to follow by introducing the problem of what I'll call top-end inequality and arguing that it should be an important focus of tax policy. My claim is that the US faces an economic and political crisis that is driven by the vast and rising share of material resources and social influence in the hands of the very richest Americans. While social scientists debate the exact extent of US inequality, once certain definitional disputes are cleared away, it becomes clear that there are few healthy democratic societies that have seen the kind of top-end inequality comparable to what the US experiences today. In addition to its corrosive political effects, social control by the richest few also can have debilitating economic consequences.

Top-end inequality is an urgent social problem that we should address with all the tools available, including tax policy. Tax systems are the key tool for addressing inequality in almost every serious policy analysis. Indeed for some commentators tax is the only instrument policymakers should employ when they aim to reallocate wealth (Kaplow 2010).

It's surprising, then, that prior tax reform proposals have generally considered how to make tax policy for everyone, instead of considering the unique circumstances of the ultrarich. For instance, when economists debate whether it is good or "efficient" for a society to tax investment income, they generally analyze the question as though the

same tax rules—other than the tax rate—would apply to everyone. Economists recognize, of course, that only well-off families save much at all, but they rarely distinguish between households with comfortable amounts of savings for themselves and those with riches so immense that their wealth will still remain generations later. This is too limiting because not only is the behavior of the immensely rich likely different from other families, but also because the fundamental rationale for taxing them at all might be quite different. In Chapters Four, Five, and Six, we will see repeatedly that the questions of whether and how to tax investments and inheritances depend on whether we are taxing only the very wealthiest, or instead a much broader swathe of the population.

In this chapter I therefore want to make the case that America's ultra-wealthy are so different from everyone else that they should have their own tax system, a set of rules aimed at reducing their vastly disproportionate wealth and influence. In some ways, as we will see in Chapter Three, this is an easy case to make, because wealthy US investors have in many respects already made a special tax system just for themselves. Today, wealthy taxpayers can choose when to pay tax, and which state can tax them. While most households must pay tax on their full earnings each year, the wealthiest households instead have the luxury to wait, and by waiting they shrink or even eliminate their tax bill. The wealthy have also used their outsized and tax-subsidized influence to further whittle their tax obligations through a series of special rules that only they can claim.

Measuring US Top-End Inequality

By any measure, US wealth is highly concentrated. According to Federal Reserve estimates based on survey data, the top 1 percent of households control 30 percent of US private wealth (Aladangady et al. 2023; Board of Governors of the Federal Reserve System 2025). Yet even that understates things. Researchers with more comprehensive data find higher shares held by the very top households, and that this share has risen over time (Smith, Zidar, and Zwick 2023; Saez and Zucman 2020). Survey data suggest that the top 0.1 percent, or the richest 340,000 of 340 million people, own roughly $1 in every $6, with more comprehensive data reporting they own a few percentage points more (Smith, Zidar, and Zwick 2023; Saez and Zucman 2020).

Research has differed somewhat on the extent to which top-end inequality has changed in the US over time. For example, while some researchers find that the share of income collected by top earners increased by as much as 67 percent (from 9 percent to 15 percent) between 1960 and 2020 (Piketty, Saez, and Zucman 2018), others find a rather more modest increase of about 12 percent over that span (Auten and Splinter 2024). Yet others find something in the middle, around a 30 to 40 percent ramp-up (Gale, Sabelhaus, and Thorpe 2023). For wealth inequality, the debate is whether the share of US wealth held by the top 0.1 percent has more than doubled since 1960, or

whether instead it has merely grown by 67 percent (Smith, Zidar, and Zwick 2023; Saez and Zucman 2020).

One reason expert opinions about inequality vary is because there is disagreement about how to take account of government transfers (Gale, Sabelhaus, and Thorpe 2023). For example, Auten and Splinter (2024) argue that the share of income held by the lowest US deciles rises significantly if we include government transfers in each household's total available income stream. This is a sensible approach if we are interested in assessing how society currently treats the poorest households, relative to others. The danger in relying exclusively on that number is it might lead to what could be called the umbrella fallacy: throwing away your umbrella in a rainstorm because you're not getting wet. It's important to know if it's also raining, and so compiling data on what society would look like *without* transfers is also essential to understanding whether our current tax and transfer policy is worth the cost.

In any event, this debate is mostly a sideline for the question of top-end inequality. Government transfers are a tiny share of the wealth of top households. If we are looking to inequality data to understand whether the wealthy have disproportionate wealth and influence, it is not obvious that it matters at all whether lower-decile households receive transfers or not. Low-earning families are not using nutrition assistance benefits to counterbalance the political influence of the ultrarich. Instead, our main interest will be in pre- and post-tax measures of top-end wealth. Again, we are interested in both numbers, because a comparison of the two can tell us about the extent to which the tax system is mitigating inequalities that arise throughout the rest of the economy.

Measures of wealth across households also involve some other tricky conceptual issues that can make direct comparisons a bit misleading, and may undercount the true fortunes of the better-off. For example, existing data mostly attempt to measure each household's current wealth. For lower-earning households, current wealth is often a good approximation of the family's marginal utility, or how much benefit they get from the next dollar they spend or earn. What the family has now is all they have access to. But households with access to credit and insurance markets—usually those with higher earnings—often can get more money when they need it. This borrowing power is not directly measured by current wealth, so that top-end households are even better off than the numbers say.

In short, while there is some disagreement about all the particulars of US inequality, there is little dispute that top-end inequality is unusually high. In the US, the last era of inequality of this extent was a time of robber barons, dramatic economic collapses, and constitutional upheaval (Saez and Zucman 2020). This is probably not a coincidence, as I now will explore.

Social Costs of Top-End Inequality

A deep sociological and political science literature attests to the social costs of concentrated wealth and power, and the corresponding benefits to even incremental reductions in extreme inequality (Link, Phelan, and Hatzenbuehler 2014). My coverage here can be fairly summary because there have been several powerful and accessible recent accounts elsewhere, including McKay and Wolf (2023), Madoff (2025), Collins (2021), Repetti (2020) and Saez and Zucman (2019).

At the macro level, wealth concentration tends to mean that the nation delivers what's good for the wealthiest, not for everyone else (Glaeser, Scheinkman, and Shleifer 2003). For example, because they have enough influence to achieve their goals without coordinating much with others, family dynasties can achieve policy outcomes that a comparably-resourced collective could not (Morck, Wolfenzon, and Yeung 2005). Because they do not have to rely on outside financing, they can acquire key assets that deliver power in the future—media companies and infrastructure, say—without having to worry about the liquidity needed to keep afloat until power arrives (Morck, Wolfenzon, and Yeung 2005). At the micro level, researchers find at least correlational linkages between highly unequal societies and deep individual stress, anxiety, and discontent with moderate success, even among the relatively affluent (Buttrick and Oishi 2017; Wilkinson and Pickett 2010). Unequal societies experience weak institutions, social divisions, and diminished interpersonal ties (Chong and Gradstein 2007; Malleson 2023). Rising wealth concentration means a diminishing sense of autonomy for others, which is unsurprisingly demoralizing and frustrating (Link, Phelan, and Hatzenbuehler 2014).

There are also purely economic accounts of the costs of highly concentrated and dynastic wealth, as well, though the causal evidence is not always overwhelming, and often drawn from data for developing economies. Inequality weakens competitiveness and economic efficiency (Baselgia and Foellmi 2023; Halter, Oechslin, and Zweimüller 2014; Stiglitz 2015). Dynasts use their power to protect their own interests, and often those interests are not the best use of investor or state resources (van der Weide and Milanovic 2018; Morck, Wolfenzon, and Yeung 2005). Firms controlled by families are apt to be less innovative and tend to underperform over time, and countries where this is common can lag in economic growth as a result (Caselli and Gennaioli 2013; Gedajlovic et al. 2012; Morck, Wolfenzon, and Yeung 2005).[11] Societies with highly concentrated wealth are generally less resilient to crises, perhaps because they tend to select for officials who are compliant with the ultrarich and willing to indulge their

[11] For evidence that later generations of family firms generally perform poorly, see Bloom and Van Reenen (2007) and Smith et al. (2019). Gedajlovic et al. (2012) also notes that evidence showing that later generations of family firms perform poorly is "compelling."

idiosyncratic preferences, rather than choosing for competence or even a diverse set of ideas (Gamage and Brooks 2022). Many of these societies experience ruinous inflation, likely because of their inability to credibly commit to setting aside the preferences of their leaders in favor of long-run good policy (Morck and Yeung 2004). These factors in combination may explain findings that economic opportunity is scarcer in highly unequal places (Chetty and Hendren 2018).

Acemoglu and Robinson (2012) offer an especially compelling account of the ways in which narrow control by a select group of powerful insiders undermines economic development. In societies such as these, private property rights for other individuals are no longer fully safe. Instead ideas, plans, and businesses can be seized or derailed by powerful insiders, who may act out of economic self-interest, ideological opposition, or even just personal vendetta. Whatever their reason, narrow interests with sufficient influence can manipulate the levers of public power to undermine rivals. Unsurprisingly, Acemoglu and Robinson find that societies such as these sap incentives for innovation and entrepreneurship. Success by a member of an out-group just makes them a potential target for hold-ups or expropriation by the in-group.

Though they don't quite spell out their story in traditional tax economics terms, Acemoglu and Robinson in effect turn a traditional economic account of taxation upside down. In the standard account, highly progressive taxes can reduce incentives to invent or start new businesses, because the after-tax returns of such risky activities are diminished. And in a healthy democracy, there is at least some degree of truth to that account, as some researchers find somewhat lower patenting activity as tax rates on business income increase sharply (Akcigit, Hanley, and Stantcheva 2022). Yet in expropriative economies such as the ones Acemoglu and Robinson study, the reverse might well be true. It is the existence of an oligarchic in-group that acts as a kind of tax on entrepreneurship (Aidis, Estrin, and Mickiewicz 2012). A highly progressive system, to the extent that it can level out these kinds of power dynamics, might open new opportunities in the economy and give small business owners confidence that they can keep the rewards of their efforts instead of being punished by powerful entrenched interests.

While Acemoglu and Robinson would not likely characterize the US as a fully expropriative economy, there are certainly troubling movements in that direction. Even before the current administration's many efforts to punish its political enemies and reward cronies and insiders, the US economy was increasingly one in which powerful individuals and firms commanded greater and greater policy and economic influence. Data on the rising share of firm profits kept by investors, and the share of economic "rents" captured by sellers instead of consumers, both point broadly in this direction (De Geest 2018; Eggertsson, Robbins, and Getz Wold 2021; Stiglitz 2015; Taylor and Ömer 2020).

The Ultrarich Are Different

Largely for these reasons, the story of top-end inequality is about a narrow group of families who wield vastly outsized social control, and not about the broader group of households whose savings provide mainly for their own retirement and the educational attainment of their children. Alex Raskolnikov argues to the contrary that redistributive tax policy should at least include efforts to reach these upper-middle class families, perhaps the top 10 or 20 percent of households by wealth (2023). In his view, these families, too, have relatively lower marginal utility of wealth, make large campaign contributions in the aggregate, and "hoard" or control opportunities for intergenerational advancement.

While there may be some gray area at the edges, it seems clear that some families have power and the opportunities to transmit it that are categorically different from what is available to the average professional. It is these families of whom the Meade Committee, the distinguished team of UK economists, said in 1978, "The holding of wealth itself, whether it arises from inheritance or from the owner's own efforts and savings, can confer on the owner benefits of security, independence, influence and power, quite apart from any expenditure which the influence from it may finance" (IFS 1978, 351). The Meade Committee's argument was an intuitive one, but today it also has powerful evidence in its favor. The easiest examples here are single families that own controlling stakes in nationwide or major regional businesses: the Waltons, Murdochs, and Buffetts, for example (Collins 2021). For these families, inheritance goes beyond mere material assets to include the prestige, social capital, and connections of their famous names (Tait 2021). The wealthy in America increasingly drive political outcomes (Gilens and Page 2014; Hacker and Pierson 2010).

Even setting aside the power of money, control over business assets and operations grants dynastic families a kind of influence that few others can match. Obviously, big businesses today can have important influence over the economy and society, whether through their supply chain choices, their hiring practices, or what they choose to make and sell (Foley et al. 2021; Arndt 2023). Increasingly, their data about how to reach consumers, and what those consumers want, give them a kind of cultural reach that few institutions can match (Cohen 2019). And of course some enterprises directly convey the power to influence what the public hears and sees, whether via cable news or social media posts (Petrova 2008; Zuboff 2019). Others can literally shape the future through control over key components of national infrastructure, whether shipping companies or battery manufacturers (Bivens 2017; Congressional Budget Office 2020). By offering to put these powers at the disposal of favored elected officials, business owners can turn their economic might into political influence (Fishkin and Forbath 2022; Tait 2021). Other businesses can bend local officials to their side by threatening to relocate jobs or investment dollars (Fisher 2007; Schragger 2009).

Perhaps members of the professional class can assemble political power in the aggregate, but what distinguishes the ultrarich is that they do not need collective action to achieve their aims. Unlike most business owners, dynasties do not have to share control of these kinds of powerful institutions with thousands or millions of other owners (Morck, Wolfenzon, and Yeung 2005). In a typical publicly traded company, equity owners can influence the firm only very indirectly, through their vote for a board of directors that in turn selects and writes contracts with managers. Coordinating with others who have similar preferences for the firm's behavior is often costly and difficult, and owners must at the same time guard against the coordinated efforts of others who might have contrary goals (Triantis 2003). But Mark Zuckerberg, who owns a controlling share of the votes of Meta, has no such problems (Arndt 2023; Tait 2021). If Zuckerberg wants Meta to spotlight political communications (as he did in 2020) or downplay them (as he did in 2024) (Treisman 2024), that is largely his decision to make, albeit subject to potential costs if markets believe his choices reduced the value of the firm.

Alternatively, consider families whose wealth is vast but diversified. There are about 800 billionaires in the US today, and their collective net worth ($6.2 trillion, or 3.8 percent of all privately-held wealth) well exceeds the combined wealth of the 165 million poorest Americans (2.5 percent of all private wealth) (ATF 2024). This kind of buying power can drive markets—even found new cities (Dougherty and Griffith 2023). And with restrictions on campaign and political spending growing increasingly ragged, money today is easily turned into political influence (Levinson 2016; Yablon 2017). It's been reported that in 2024, billionaires alone spent more on US elections than the entire country's political spending in 2020 (Massoglia 2024). Where today political movements squabble over leadership and priorities, billionaires are political movements unto themselves, buying their way into cabinet seats and even forging new political parties.

Campaign finance reform, unfortunately, does not look to be a viable alternative. For one, many of the most important forms of influence massive wealth today provides are not within the reach of traditional limits on political spending. The very rich influence policy outcomes through business choices about what to buy, where to build, how to invest, and who to hire. They steer the policy information environment directly, through media and data aggregation services (Cohen 2017; Nichols and McChesney 2013), as well as indirectly through regulatory comments, sponsored research, think tanks, amicus briefs, and a similar set of strategies (Carpenter et al. 2024; Mooney 2007; Oreskes and Conway 2011). Purchasing power can expand influence on this front, too, as professionals who take positions at odds with wealthy client interests risk future business (Lancieri, Posner, and Zingales 2023). President Trump's extortionate deal with law firms, in which he threatened to revoke government contracts and other benefits for noncompliant firms, was an especially blatant but not otherwise unusual example,

except in its use of the government's purchasing power rather than that of an individual client.

In addition, infamously, US campaign finance regulation is if not completely toothless then at least on its last few teeth. As of the beginning of 2026, the Supreme Court has agreed to hear a case that would weaken the existing limits even further, by potentially allowing putatively independent organizations to coordinate their spending directly with political campaigns.

Philanthropy can be another tool of power, prestige, and influence. Of course, wealthy donors can directly fund projects they favor, often aided by tax rules that give especially generous treatment to owners of highly appreciated investment property (Madoff 2025). The Ford family and other philanthropic innovators pioneered the use of foundation money to develop and publicize data on their preferred policies, helping them to gather additional political and financial support from voters and governments (Fleishman 2007). These same strategies can also advance funders' private economic or reputational interests (Giridharadas 2018; Madoff 2010), as in the infamous case of the Sackler family's prodigious use of charitable naming rights (Keefe 2021). The power to advance and spotlight select goals in turn offers philanthropists the opportunity to play a kind of kingmaker, putting them at the center of a scramble for attention, praise, and perhaps other favors (Madoff 2025; Schizer 2009), and sometimes yielding formal legal power through board memberships, as well (Schizer 2009). Federal tax law does little to constrain these many personal side-benefits of charitable giving (Galle and Madoff 2023).

Again, these are all distinctive features of charitable giving by the ultrarich, not the merely comfortable. At best, most donors exercise influence only in the aggregate, by letting their dollars flow to organizations that achieve and report their preferred outcomes. They lack power to drive an agenda or priorities, or to extract favors or prestige in return for their support. And current tax law gives these donors much less support than it offers families with enough appreciated wealth to trigger estate tax.

Lastly, the very wealthy differ fairly markedly from other families on the traditional tax policy criterion of the marginal utility of wealth. All else equal, governments should be funded by tax revenue that inflicts the lowest possible burden on the payers. That is the fundamental appeal of progressive taxation: Giving up 10 percent of your income is far less painful when that 10 percent slice is buying a vacation home in Greece than when it is needed to stave off eviction. And the richest 1 percent, particularly at the top end among the 0.1 percent wealthiest households, appear to have much lower marginal utility even than professionals in the top 10 or 20 percent of household wealth. The top 1 percent spend a much smaller share of their lifetime income than the top 10 percent (Fisher et al. 2020).

Perhaps it is the case that the very wealthy prioritize their children more than the merely well-off; I explore the possible implications of saving for bequests in Chapter Six. It seems much more likely, however, that the top 1 percent have so much money they literally cannot spend it all, and even more so for the top 0.1 percent. Taxing those funds would be relatively costless, compared to the impact of taking money from those who actually need it to live their preferred lives. Since 1976, the wealth of the US top 0.1 percent has grown three times faster than that of the top 10 percent (Blanchet, Saez, and Zucman 2023), implying that this gap has grown even more sharply over time.

Concluding Thoughts

The data I've just reviewed offer a compelling case for tax reform. Large accumulations of wealth offer power and satisfaction by their existence alone, a benefit that as we will see in the following chapters traditional tax systems have not accounted for. So, too, concentrated wealth at the scale of the modern US is a serious threat not just to economic growth but to a participatory democracy open to everyone. Historically, as we'll see, that was a central concern of the framers of the US estate tax, but with the slow crumbling of that system our tax institutions again are failing to account for this fundamental feature of our economy. In the next chapter, I consider why the income tax hasn't filled those gaps, and indeed why it is structurally incapable of doing so.

Chapter Three: The Realization Dilemma

• Today's income tax is based on the realization principle, which taxes investment gains and losses only at the time an investment asset is sold.

• It is very difficult to implement a meaningful tax on the ultrarich using a realization-based tax system. Realization allows wealthy investors to choose when and where to sell, and because of the time value of money their resulting effective income tax rate is lower than for many middle-income families.

• Annual taxes on wealth or changes in wealth are potential alternatives to a realization-based system. A tax based on annual changes in wealth is known as a "mark-to-market" tax.

• Recent legal developments at the Supreme Court raise questions about whether a comprehensive wealth or MtM tax would be constitutionally permissible.

Chapter Two argued that top-end inequality is a significant American problem that tax systems can and should address. But a natural follow-up question would be whether we need new tax structures just for the very richest households, or whether it would be enough to simply rely on an income tax with progressive rates. Indeed, Sarin, Summers, Zidar, and Zwick (2022) argue that the US should simply raise rates, especially on investment income, rather than pursue more complex reforms.

This chapter will argue that while raising effective rates on investment income is a key part of meaningful tax reform, doing so within the framework of existing substantive tax rules is unlikely to succeed. Current law depends heavily on the concept of "realization," or taxing investment gains only when an asset is sold (or "otherwise disposed of").[12] Realization heavily favors wealthy investors over others, and especially favors those with the luxury of waiting decades or even generations before selling their assets. A realization-based system has only limited revenue potential, no matter what the rate, because high rates will encourage the wealthy to dig deeper into their bag of realization-exploiting tricks.

For those reasons, it's better to tax wealth accumulation as it happens, rather than many years later. As I explained in the Introduction, that approach is usually called a "mark-to-market" tax. Alternatively, Congress could simply impose an annual tax on all large wealth accumulations, whether that wealth has been recently sold or not. While

[12] Despite the broad language of "otherwise disposed of," gifts and bequests are not treated as sales today. Instead, that language mostly covers situations that are economically similar to sale but formally distinct, such as foreclosures.

those two options are formally quite different, under certain assumptions they end up producing similar results: The rich pay a fair share of their accumulation each year. Recently, however, the Supreme Court has hinted that it might view a comprehensive wealth or MtM tax as unconstitutional. The chapter therefore closes with a summary of that decision, and an analysis of what it suggests about permissible legal avenues for reform.

The Realization Principle

In order to understand why the realization principle is such a large obstacle to meaningfully reforming taxation for the very wealthy, let us first take a step back to understand what realization is and why tax systems often employ it. The defining feature of an income tax is that it taxes annual changes in a taxpayer's wealth. To tax changes in annual wealth, though, we must be able to measure it. Appraisals are expensive and, when stakes are high, often result in costly litigation. In recent decades, taxpayers have been able to bring more resources to these disputes, so governments very often lose (Cunningham and Schenk 1991). Governments cannot just give up on these contests because the cost of litigating, if nothing else, likely constrains the most abusive taxpayer undervaluation efforts. But the government stands a strong chance of losing money in each individual contest it enters. Engaging in this process every year for every asset is not remotely realistic.

Highly related to the valuation challenge, liquidity issues pose further obstacles to levying annual taxes on wealth or on increases in wealth. The most familiar example for many readers is probably in the context of local property taxes imposed on the assessed value of residential property. Retired homeowners with no incomes but highly appreciated property may not be able to afford their property tax bills (Hayashi 2017). In addition to potential fairness concerns, liquidity can also have "allocational efficiency" effects: Taxpayers who are afraid of an unpayable tax bill may avoid illiquid assets, even if those assets would otherwise be their best investment option.

A sale for cash solves both the valuation and liquidity problems. Value, after all, is usually just what a willing buyer will pay to a willing unrelated seller. And if the sale is for cash, the seller can generally set aside a portion of the sales proceeds to pay their tax bill.

That is the basic logic of the realization rule. Instead of taxing annual changes in a taxpayer's assets, modern tax systems overwhelmingly wait to assess tax until an asset is either sold or disposed of in a sale-like transaction. At sale, the seller has income equal to their sale price minus their basis. Tax systems typically treat barter transactions as the equivalent of cash sales, even though in-kind swaps don't perfectly solve the valuation and liquidity problems, on the assumption that most barter transactions could have been conducted in cash (Zelinsky 1997).

The realization principle helps to resolve the valuation challenge, but at enormous social cost. First, realization affects the timing of when taxpayers sell their property. In general, it's better to pay taxes later than it is to pay them today because deferral allows taxpayers to retain the time value of the money they would otherwise owe the government.[13] Because under a realization rule the taxpayer can defer tax indefinitely, as long as they continue to hold a piece of property, the rule offers a strong motive to delay sale. In the US, this motive is made even more powerful by a special rule for inheritances. Death is not treated as a realization event, and heirs essentially owe no income tax on any of the value an asset gained while it was in the hands of the decedent (this rule is known to tax mavens as the "basis step-up at death"). Empirically, this combination of rules has been shown to powerfully constrain investors' willingness to sell their property, at least for those whose assets are held outside of tax-favored retirement accounts (Auten and Joulfaian 2001).

While realization makes taxpayers want to keep their appreciated property, it also may encourage disposition of property that has lost value. Realized losses allow taxpayers to claim deductions, potentially reducing taxable income. Holding onto loss properties postpones this deduction, leaving tax payments in the hands of the government. In some cases, taxpayers may dispose of investments it would be more efficient to retain solely to harvest their tax benefits sooner (Auerbach and Poterba 1988).

Realization not only changes when taxpayers sell property but also affects what they choose to buy in the first place. To buy a new asset, the taxpayer often must sell an existing one. But doing so would result in immediate taxation if the existing asset has gained value while the taxpayer owned it. Often, it is economically rational to refuse to invest in a profitable new opportunity because the present value of switching is less than the cost of paying taxes on the swap. This is what is often known as the "lock-in problem."

This combination of deleterious effects is why simply raising rates on investment income is unlikely to solve any important social problems, or would have limited revenue potential (Leiserson 2020). Currently, realization allows about half of economic income to escape taxable income for the top 0.1 percent of households by wealth (Fox and Liscow 2025), but this is not a fixed percentage. The Joint Committee on Taxation, for example, estimates that increases in capital gains rates are relatively ineffective revenue-raisers, and indeed may become revenue-losers as the rate rises, because when tax rates rise taxpayers sell fewer assets, among other potential tax-avoiding

[13] Take Chen. Chen has the choice of paying $100 in tax this year or next year. If Chen defers payment, she can invest the $100 for the intervening year. Suppose that she earns a $10 investment return on her $100 investment, then pays a 20 percent tax on that return. Thus, if Chen opts to delay payment for a year, her net tax bill is effectively only $92 (that is, $100 – ($10 – $2))—as opposed to the $100 she would owe if she paid today.

responses. Thus, they estimate that a 5 percentage-point increase in the capital gains rate, from 23.8 to 28.8 percent, would raise only about $100 billion over 10 years (Gravelle 2022), a bit more than the cost of the charitable contribution deduction for donations to hospitals (which are one-fifth of all donations) over that period. A 10 percentage-point increase would likely raise considerably less than $200 billion because of the sharp increase in tax-minimization efforts it would engender.

Research by Agersnap and Zidar potentially implies that rate increases would raise more money than the JCT finds, but more recent work sheds some doubt on that conclusion. Specifically, Agersnap and Zidar use changes in state tax rates to estimate the impact that federal changes would have on asset sales (2021). Their resulting estimate of the federal-level "elasticity" or responsiveness to tax rates is much lower than the elasticity the JCT assumes, resulting in a projected revenue figure that is nearly three times higher (Gravelle 2022). Goodman and Sprung-Keyser (2025), however, revisit the question of state tax changes using more precise individual taxpayer data, and find that the implied federal-level elasticity is much larger than in Agersnap and Zidar (2021), and more in line with the JCT's assumptions. The weight of the evidence appears therefore to be that rate increases by themselves are unlikely to reach a significant fraction of investment income.

Further, relying on a realization-based tax approach would likely worsen, not improve, economic inequality. In granting investors, and only investors, the option when (and, ultimately in many cases, whether) to pay tax, realization principles disproportionately benefit those who hold investment assets or who can borrow at favorable rates to obtain investment assets (Zodrow 1992).[14] In the US, nearly all that benefit goes only to the very richest taxpayers. For example, about 90 percent of all US individual stock ownership is concentrated among the wealthiest 10 percent of Americans.

While realization is broadly valuable to investors, it is especially important to the fortunes of the very wealthiest. Recent reporting has highlighted the fact that some of the world's richest people, such as Jeff Bezos, have reported close to zero taxable income in some recent tax years.[15] That was possible, even as Bezos's wealth was launching into orbit, because the realization rule did not oblige Bezos to treat his gains as taxable income. To pay his bills, he was able to borrow against his existing stock holdings, because borrowed funds are not taxable income, either (Fox and Liscow 2025). These sorts of tax-gaming strategies are commonly used by ultra-wealthy taxpayers, and, as a result, scholars estimate that more than three quarters of the true investment gains of ultra-wealthy individuals and families fully and permanently escape income taxation (Gamage and Brooks 2022).

[14] Of course, we could adjust tax rates to offset this effect (Zelinsky 1997), but we don't; to the contrary, those with deferrable assets typically pay lower, capital gains rates.
[15] *See, e.g.*, Eisinger, Ernsthausen, and Kiel (2021), *supra* note 1 (reporting Bezos paid an effective tax rate of 1.1 percent from 2006 to 2018 and did not pay any federal income taxes in 2007 and 2011).

Even when wealthy investors do realize their gains, they pay a lower rate of tax on them than many other taxpayers. Like many other countries, the US imposes a lower rate on capital gains, which are generally profits from the sale of investments; currently the effective tax rate on investments for top earners is 23.8 percent, versus 40.8 percent for wage income. The lower capital gains rate is a compromise necessitated by the lock-in problem. We offer investors a break on their taxes so that they will be willing to sell an appreciated asset rather than continue to hold it until death. That reduces the economic drag caused by investors' accumulated decisions not to switch from low-performing but appreciated investments to stronger investments that would drive greater economic growth. But, of course, because it is mostly rich taxpayers who hold highly appreciated investments, we buy this economic growth at the cost of greater inequality.

The realization principle also has other social costs. For example, implementing a workable realization system makes the income tax system much more complex, which in turn contributes to further inequality (Shakow 1986; Weisbach 1999). Among other issues, realization requires complex rules for determining when a sale has actually occurred (Raskolnikov 2005) and which assets should receive favorable capital gains rates (Auerbach and Poterba 1988) and it has inspired a host of even more complex special exceptions for favored transactions, such as corporate reorganizations.

The MtM Taxation Alternative

Raising rates on investment income would be far more effective if we didn't tax wealthy investors only when they choose to sell. For example, Gravelle (2022) estimated that the same 5 percentage-point increase in the capital gains rate, if it were paired with a reform that extended taxable income to include unrealized gains, would raise something like $600 billion over 10 years: $200 billion immediately, and then an additional $40 billion per year. The idea of taxing wealth accumulation before sale is hardly new, with serious proposals at least extending back to William Vickrey's *Agenda for Progressive Taxation* (1947). The basic idea is simple: Each year, a taxpayer includes in their taxable income the increase in value of their investments, and claims deductions for losses in value, just as if those gains and losses had resulted from sales.

MtM taxes are close cousins of wealth taxes, and have many similar economic and legal features. A wealth tax, generally speaking, is an annual tax on the value of a household's assets. A common US example is the real property tax, imposed by state and local governments, in which homeowners pay an average of about 1 percent of the value of their residence each year in tax. A broader-based wealth tax would reach most or all assets, not just homes.

Over time, wealth and MtM taxes can look very similar. Suppose, for instance, that the average appreciation in investment properties nationwide is 5 percent. A 20 percent income tax, imposed on an MtM basis, would result in an average annual tax burden of 20 percent × 5 percent, or 1 percent of the value of each asset. In other words, it would look almost exactly like a 1 percent annual tax on wealth. The main difference is that the MtM tax would take annual changes in economic conditions into account more quickly. For instance, in a year where assets in the economy lost 1 percent of their value, there would be little MtM tax paid, but wealth tax receipts would decline by only 1 percent. As I discuss more in Chapter Ten, this difference allows a wealth tax to be simpler to design and administer.

Global experience suggests that realization is not a necessary component of a successful tax system (Hourani and Perret 2025; Galle, Gamage, and Shanske 2023). Valuation problems are not nearly as serious for some, maybe most, assets (Shaviro 1992). Value is central to the functioning of modern markets, after all, so market actors are highly motivated to develop valuation tools. Exchanges, for instance, now track the value of many securities by the millionth of a second. For complex non-traded assets, buyers often use contract features that allow the purchase price to vary depending on the economic performance of the asset during a period after sale, a mechanism typically known as the "earn out." Arguably, tools like these could allow many assets to be taxed annually instead of being subject to the realization rule. Similarly, the Swiss wealth tax system assesses private businesses based on their book assets and earnings, which can accurately capture value for a majority of firms (Galle, Gamage, and Shanske 2023).

Nevertheless, by conventional wisdom, it isn't practical to tax some major categories of assets annually and others only at sale, at least for most taxpayers (Hourani and Perret 2025). If taxpayers dislike annual taxation, then subjecting different categories of assets to different rules will distort investors' choices. Trying to draw legal lines between assets may also be difficult to implement. In the modern financial world, it is easy to reconstruct the underlying economics of one financial instrument using combinations of other instruments (Warren 1993). For example, if Betty wants to invest in ArchCo stock, but stock is taxed annually, she can instead purchase a notional financial contract that pays her based on the performance of ArchCo. If the financial contract she purchases is privately offered and not traded on an exchange, she might be able to escape annual taxation, despite having made essentially the same financial investment as if she had bought the stock outright. An exception here might be if complex financial instruments are subject to MtM treatment, as they often are in the US today.

Global experiences largely bear out these broad points. While few countries have tried broad-based MtM tax (aside from a pending Dutch legislation), there have been a number of viable wealth tax regimes. Many of the most durable wealth tax systems have broadly taxed most assets and used simplified tools, such as the Swiss book assets and

earnings approach, to reach hard-to-value assets (Galle, Gamage, and Shanske 2023). This strategy limits any incentive for investors to switch to opaque assets. In contrast, the former French wealth tax, which included only publicly traded assets, staggered and then collapsed under the weight of tax avoidance.

Having said that, there certainly would remain at least a subset of assets and taxpayers for whom annual taxes on wealth or investment gains would be difficult, economically burdensome, or both. Simply exempting those households from tax could over time weaken the tax and perhaps the economy, as investors shifted to hold assets that were entitled to exceptions. Chapters Seven and Eight consider design alternatives that allow policymakers to tax wealth or investment gains without adding these loopholes. In particular, these chapters explore alternative forms of "retrospective" taxation in which for at least some select assets taxpayers can accrue tax liability each year but don't have to pay until they actually sell the underlying asset.

Constitutional Considerations

Recent Supreme Court developments potentially complicate MtM tax reforms, however. In *Moore v. United States*, a 2024 decision, the Court upheld a tax that the litigants and many observers described as an MtM tax, but the justices suggested that other MtM taxes might not fare as well. To understand *Moore* and what it might mean for reform efforts, we have to begin with some background on what the Constitution and the Courts have had to say about income taxes.

Historical Background

The US Constitution provides that "direct taxes shall be apportioned among the several states . . . according to their numbers . . . no capitation, or other direct, tax shall be laid unless in proportion to the census." (US Const. art. I, § 2, cl. 3; art. I, § 9, cl. 4). This rule of "apportionment" means that any tax that is classified as "direct" has to collect revenue pro rata by state population. Suppose that a federal tax on palm trees is supposed to raise $100 billion. One billion dollars of the tax must be paid by Nebraska residents, because Nebraska is 1 percent of the US population. If there is only one palm tree in the state, that tree's owner will owe the entire $1 billion bill.

Obviously, this is a strange way to run a tax system. While the federal government did impose apportioned taxes on real property for a time, it abandoned them as soon as it developed the alternative of an income tax, in 1861 (Brooks and Gamage 2023).

As James Madison wrote, no one ever quite knew what the Constitution meant by the term "direct" tax (Mehrotra 2013). The phrase had a number of competing usages in the late 18th century. The concept of apportionment was added to the Constitution as part

of the infamous Three-Fifths Compromise, under which states in which slavery was legal would be able to count three-fifths of enslaved persons for purposes of representation in the US House of Representatives, but in return would have to count those same persons for purposes of calculating their apportioned share of "direct" federal taxes.

By the time the 13th Amendment passed Congress in 1865, it might have seemed to the members that there was no need to strike out the Direct Tax Clauses (Ackerman 1999). An early Supreme Court decision in 1796, which was both argued and decided by men who had drafted the Constitution, held that there were very few taxes that would count as "direct" for constitutional purposes. Two of the justices wrote that it would not make sense to treat a tax as "direct" if it couldn't be readily apportioned. That left the "capitation" or per-person taxes mentioned in the Constitution as perhaps the only plausible example, although taxes on land were another possibility; Congress would adopt its first apportioned real property tax in 1798. While not all the justices wrote to explain their views, the court agreed that a tax on the ownership and use of carriages was not "direct." Between 1869 and 1894, the Court would hold that line several more times, including in 1881 by rejecting the argument that the Civil War income tax was unconstitutional as an unapportioned direct tax.

But the Court then shocked the country by deciding, in *Pollock v. Farmers' Loan & Trust Co.*, that the 1894 income tax bill indeed was an unconstitutional, unapportioned direct tax (Mehrotra 2013). Taxes on the ownership of both land and other forms of property are direct, the Court decided, and since income is "derived from" property, it too must be a direct tax. Widespread anger and disbelief followed, and as soon as 1900 the Court was rapidly walking back its decision. In quick succession, it upheld taxes on commodity sales, inheritances, tobacco held for sale, profits from selling sugar, and corporate income.

The last of these, the decision upholding the corporate income tax, was especially striking: Allowing unapportioned taxes on *corporate* income was fully consistent, the Court claimed, with its earlier holding that taxes on *individual* incomes had to be apportioned. How could that be? The Court explained that direct taxes were those that were imposed "solely because of the ownership of property." A corporate tax instead was imposed on a particular use of, or "privilege," related to property: the grant of the right to do business in corporate form. Many commentators, including the future President and Chief Justice William Howard Taft, found this distinction hard to credit, and predicted the Court would overturn *Pollock* if given the chance (1908).

Instead, Congress drafted, and the states then ratified, the 16th Amendment, which went into effect in 1913. The amendment aimed directly at *Pollock*'s holding, providing that Congress has the power to collect income taxes "from whatever source derived" without apportionment. That is, following the 16th Amendment, there are two ways for

a tax to skip the constitutional apportionment requirement. First, the tax needs no apportionment if it is not a "direct" tax imposed solely because of the ownership of property. Second, even if the tax is direct, it doesn't have to be apportioned if it's a tax on "income."

In the wake of the 16th Amendment, only one tax provision has ever flunked the apportionment test. That provision was an income tax rule that treated *pro rata* stock dividends as part of the recipient's income. The Court ruled in its 1920 decision in *Eisner v. Macomber* that such stock dividends are not "income" and so are not within the scope of the 16th Amendment.[16] Although the opinion is meandering and fairly cryptic, commentators concluded that the core rationale was that, because a *pro rata* stock dividend doesn't change the recipient's economic wealth (it's just a stock split), the taxpayer "has not realized or received any income in the transaction." (*Eisner v. Macomber*:212). Just what that meant wasn't clear. The next year, in applying the *Macomber* precedent, the Court said that it required that the taxpayer get "something of exchangeable value produced by . . . his investment . . . severed from it and drawn by him for his separate use" (*United States v. Phellis*). Somewhat similarly, an individual had income under these rules if they received "an essentially different thing" in exchange for their existing property (*Marr v. United States*).[17]

This is the proposition for which *Macomber* has long been known: that an income tax can only be defined by "realized" income, such as from a sale or cash dividend, that provides the taxpayer with "something of exchangeable value" that is "severed from" his underlying investments. Taken at face value, it would seem to rule out an unapportioned tax solely on annual changes in the value of unsold property.

But there was also another, essential, conclusion in *Macomber*. The government had asserted in its brief that, even if a stock dividend isn't itself income, treating it as income for the recipient is a way of taxing shareholders on the undistributed cash earnings of the distributing corporation. The Court brushed that argument aside, asserting that to tax a shareholder on their corporation's profits would be a direct tax because it is "taxation of property because of ownership." That is puzzling. Taxing a shareholder on a corporation's profits or change in value is obviously not a tax that is

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[16] The *Macomber* Court seemingly skipped the antecedent question of whether a tax on stock dividends is "direct," but it may have done so because it misread the government's brief as having conceded that question. Obviously the payment of a stock dividend is a particular transaction or use of property, and so taxing it is an excise, not a tax "solely because of . . . ownership."

[17] In the year before *Marr*, the Court ruled that as a statutory matter, the reincorporation of an entity in the same state does not trigger gains for the shareholders, though it relied on the same realization logic as in *Macomber* (*Weiss v. Stearn*:254). Similarly, for a brief period the Court believed that cancellation or reduction in indebtedness was not "income," though it was not clear whether that holding was based in the Constitution or just an interpretation of the IRC (*Bowers v. Kerbaugh-Empire Co.*:175; *rev'd*, *US v. Kirby Lumber Co.*:3). Some lower courts did interpret that position as a constitutional holding, though (*e.g.*, *Meyer Jewelry Co.*:1322–23).

imposed *solely* because of ownership; if the corporation had earned no profits, there would have been no tax.

In any event, the Court went on to conclude that the 16th Amendment was no help, because only the corporation, not the individual shareholder, had "income" under this theory. In reaching this conclusion, the Court conveniently neglected to mention that the same Congress that had drafted the 16th Amendment had also written a statutory provision doing exactly what the Court said the Amendment disallowed: attributing income to shareholders based on the income of the corporation they owned (Tariff Act of 1913, Pub. L. 63-16, § II(a)(2), 38 Stat. 114, 166–67) (defining individual income as including "the share to which [the taxpayer] would be entitled of the gains and profits . . . whether divided or distributed or not, of [certain] corporations"). Evidently the drafters didn't understand their own amendment. Even worse, the Court had repeatedly said in earlier cases—even in *Pollock* itself—that taxes on business income are not direct taxes that need to be apportioned. *Macomber* made no effort to explain how its outcome was consistent with those rulings.

As with *Pollock*, the Court pretty quickly backed away from *Macomber*. By the early 1940s, a series of cases had found income in situations, such as cancellation of prior debts or the return of a rental property to its owner, that could not plausibly meet the *Macomber* definition of realized gains. That led academics, and in 1943 three justices, to declare that *Macomber* was dead (*Helvering v. Griffiths*). The Court's majority ducked the issue by ruling on statutory grounds, but agreed that these later cases had "undermined . . . the original theoretical bases" of *Macomber*. MtM provisions slowly proliferated in the Internal Revenue Code (IRC), and consistently were upheld by US Courts of Appeals. In the 1990s the Court would call the concept of realization a matter of "administrative convenience," defer to the IRS's view of what it meant, and imply strongly that Congress could change it if Congress were so inclined (*Cottage Savings Ass'n v. Comm'r*)—hardly what you'd expect if realization were a core aspect of the constitutional definition of income. No court or commentator gave much attention to *Macomber*'s second conclusion—the claim that corporate earnings cannot be shareholder "income."

The Moore Case

By 2017, essentially everyone but one or two academic gadflies thought that the realization principle was dead, as a constitutional matter. That year, as part of the law commonly known as the Tax Cut and Jobs Act, or TCJA, Congress adopted an MtM rule for certain US owners of foreign active businesses. Under prior law, domestic shareholders were able to leave accumulated profits in the bank accounts of their non-US firms, giving themselves unlimited tax-free deferral until such time as the funds were paid out as dividends. Shareholders could usually delay that tax reckoning by pledging, or borrowing against, the shares, whose value naturally reflected the cash

sitting in the company's accounts. TCJA changed this rule going forward, making many US parents of active foreign businesses subject to annual tax on foreign profits. In addition, it imposed a one-time tax on US shareholders based on the amount of their "unrepatriated" and previously untaxed foreign earnings—the funds stowed in the overseas firms' bank accounts to defer US tax. Critics derogatorily dubbed this excise the "mandatory repatriation tax," or MRT, but for want of a better term the name stuck.

The Moores were partial owners of an Indian company that held untaxed profits in its account, making them subject to the MRT. They challenged the MRT as unconstitutional, arguing that it was a tax on unrealized profits, and so outside the constitutional meaning of "income" under *Macomber*. They lost easily in the lower courts, with the first court to consider their arguments finding them so readily dismissed that it did not even elect to publish its decision. But the Moores pressed their claims to the Supreme Court, which surprisingly agreed to hear them out. In their petition to the Court, the Moores, whose modest MRT tab of under $100,000 was surely a tiny fraction of their legal bills, revealed their real target: a wealth tax proposed by Sen. Elizabeth Warren (D-MA). They urged the justices to take up their case as a vehicle for ruling that all taxes on unrealized gains would be unconstitutional. When the Court accepted, many observers took their acceptance as a sign the justices would indeed reach that issue.

But the Supreme Court majority decided the *Moore* case not by resurrecting *Macomber*'s realization rule, but instead by disavowing *Macomber*'s largely forgotten second holding, the one about corporate profits. In an opinion by Justice Brett Kavanaugh, the Court held that whether or not the 16th Amendment's definition of "income" required realization, there in fact had already been a realization event for the Moores: when their corporation sold products and earned profits. Pointing to the long US history of including entity-level earnings in shareholder "income," the Court concluded that *Macomber* had gone wrong in claiming that such an approach was inconsistent with the 16th Amendment. Thus, whether or not the Constitution in effect demands realization, taxing an equity owner would meet that demand, assuming the business entity itself has realized income. Some language in the opinion even seemed to suggest that the Court now saw *Pollock* as wrongly decided. If this were so, it would imply that the 16th Amendment's definition of "income" was redundant, and that the controlling law would be the Supreme Court's 1881 holding that an income tax is an excise, not a direct tax at all.

Even so, the Court also signaled that it did not view realization as a dead letter. *Moore* holds that the government can define an individual's income to include the untaxed profits of a business entity in which the individual holds an equity stake. That holding allowed the Court to take a pass on determining whether there is any constitutional realization requirement. The Court repeated several times, however, in several different ways, that a realization requirement could be a constitutional obstacle

to wealth or MtM taxes, and it was not deciding those questions. Four dissenting justices argued that realization was constitutionally required (mostly by pointing to the misleadingly-edited snippets of 19th century text that the Moores' lawyers assembled; friend-of-court briefs filed by real historians carefully dismantled those claims).[18]

Where, then, does *Moore* leave efforts to tax unrealized wealth? In part the answer depends on what constitutional scholars sometimes call a "level of generality" problem. As with shareholder-level taxation of corporate profit, there is a long history of MtM provisions in the US income tax, dating back to the Civil War. Before 1913, farmers, insurance companies, businesses holding investment assets, and even homeowners in Wisconsin paid income tax based on unrealized gains or losses. In any future challenge, the government could readily point to these provisions as evidence that at the time of the 16th Amendment, realization was hardly a universal component of "income."

Conceivably, though, Justice Kavanaugh might frame the historical question differently. He might ask, "Is there a long historical tradition of broad-based income taxation on an MtM basis, as opposed to certain small, special applications?" If that were the question, the answer would be "No." On the other hand, over the last 50 years, MtM rules have evolved into an essential set of anti-abuse devices, particularly with respect to overseas assets and financial instruments.[19] If these were weakened, there would likely be a devastating run on US mutual funds. Yet there are ways out of that dilemma for the Court. A rule that was framed not as "all MtM rules have historical pedigree," but instead less generally as "narrowly applied anti-abuse rules have historical pedigree," would let the Court keep in place these economically vital provisions without blessing broad new efforts to tax unsold wealth. This framing would leave the majority justices with the discretion to decide which favored provisions count as permissibly narrow and which disfavored rules are impermissibly broad.

In short, there now is a fair bit of constitutional uncertainty about whether realization is necessary for an "income" tax. Narrow provisions that rely on MtM principles in support of other income tax rules might be safe, but more ambitious efforts to rearrange the timing of income taxation for large swathes of untaxed gains might not. Defenders of these provisions have yet more solid arguments to offer, such as the possible suggestion in *Moore* that, since *Pollock* was wrongly decided, income taxes are excises, not "direct" taxes, and so do not need to be apportioned. But these arguments are as yet untested.

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[18] By way of full disclosure, this author wrote one of the historian briefs, which was cited by Justice Ketanji Brown Jackson in her concurrence.

[19] An especially important but little-known rule is Section 1256, which imposes MtM treatment for offsetting positions in options and futures contracts. Without this rule, a sufficiently liquid taxpayer could always wipe out their capital gains for the year at low cost by entering into offsetting positions, then selling the losing side on December 31 and the winning side on January 1.

A more reliable approach would be simply to use more taxes that the Court has long described as excises. Taxes aimed at inherited wealth, or wealth held through trusts or other business entities, would obviously be constitutional. Even at *Pollock*'s peak, between 1895 and 1913, the Court upheld income taxes on business or legal entities distinct from their individual owners as excises on the privilege of doing business in corporate form. It approved (for a second time) unapportioned taxes on inheritances, on the theory that an "excise" is by definition a tax on the transfer of an asset. And later, in 1931, it upheld the constitutionality of the federal gift tax, again because it reasoned that a gift is just a form of transfer.

These would not be small stopgaps. Estimates are that 40 percent or more of all US wealth is gifted or inherited (Batchelder 2009). Corporate profits are about 15 percent of GDP ($4 trillion out of $27 trillion).[20] Tax reforms aimed at corporations, inheritances, and trusts could address a large fraction of untaxed appreciation without raising any constitutional issues.

Recall also that classifying a tax as a tax on "income" under the 16th Amendment is just a way to avoid the apportionment requirement. Lawmakers could provide that in the event the Supreme Court determines that a tax has to be apportioned, it will be. Apportionment may be more workable than most commentators have assumed. For instance, a fallback apportionment provision for an MtM bill could state that annual taxes are apportioned, but then that there is a "true-up" adjustment when assets are actually sold. This true-up tax would add or subtract tax liability to the sum of annual payments so that, after adjusting for the time value of money, the property seller pays Congress's preferred rate of tax on the property's total appreciation. I explore this idea in more detail in Chapter Eight.

Concluding Thoughts

The *Moore* decision leaves reformers in a difficult position. While top-end inequality is an urgent social problem, the income tax looks like a poor tool for addressing it. Any tax system dependent on the realization principle will likely have only a limited ability to reach accumulated wealth and investment gains. Wealth or MtM taxes are viable economic responses but might be unconstitutional. Later, I explore tools for achieving the economic results of an MtM tax without the constitutional baggage, and for repairing taxes on inheritances. First, though, we take a detour to consider whether there are economic counterarguments that would lead us to embrace, rather than reject, legal limits on taxing investments.

[20] NIPA Corporate Profits Before Tax Q3 2024 / US GDP.

Chapter Four: The Economics of Taxing Investments

- The economic case for taxing investment income is much more powerful when it applies to the ultrarich.

- Taxes on massive accumulations of wealth are efficient because that accumulation is an apt measure of the owner's ability to pay and the extent of the social damage caused by their disproportionate power and influence.

- Contrary to some creative recent scholarship, increases in wealth do in fact make the wealthy better off relative to others, even if that increase results from changes in interest rates.

In Chapter Three, we saw that because of the realization principle, taxes on investment income are largely optional for the very wealthy. Although annual taxes on wealth or changes in wealth could be an effective answer, there are potential constitutional obstacles to those reforms. Though that answer might be troubling for many readers, a number of influential prior commentators would instead argue it leaves us in the right place: with little or no tax on investment income. For example, Auerbach (2006) and Adam et al. (2011) offer economic theory to the effect that we should generally not attempt to tax the "normal" return to savings and investment.

This chapter argues that to the extent these theoretical arguments are persuasive at all, they do not hold with respect to the savings and investments of the ultrarich. Indeed, Auerbach (2006) expressly acknowledges that his arguments might not hold for efforts to limit top-end inequality, but doesn't explore that possibility in any depth. In this chapter, I survey research over the last decade or so that has undermined the premises that supposedly justify exempting investments from tax. In the next chapter, I move from economic theory to brass tacks, asking whether there is any legally and economically viable way to implement a tax system limited only to current spending and consumption, with no burden on savings.

Arguments That Taxing Savings Is Inefficient

First, let's sketch the basic economic arguments for why tax on investments is supposed to be inefficient. The arguments come in two distinct packages. The first is sometimes associated with Atkinson and Stiglitz (1976), though both those authors now say it is mistaken. To simplify, the claim is that a tax on investments inefficiently distorts a person's choice about when to spend their money by making it cheaper to spend today than tomorrow (Bankman and Weisbach 2006). If a person decides to spend their

earnings now, they pay only one tax: the tax on their earnings. If they instead invest the money to spend later, they will pay tax on both their initial earnings and on their investment earnings. Similarly, a tax on inherited savings would distort the earner's choice between their own consumption (taxed only once) and their heirs' consumption (taxed both when earned and then again when inherited) by making it cheaper to consume than to bequeath wealth.

The second bundle of arguments is usually tied to the macroeconomists Ken Judd and Christophe Chamley. Their papers are densely mathematical, to the point where commentators vary fairly widely in how they explain what the papers actually say (Straub and Werning 2020). Reading them generously, they could be understood to assert that over several generations, the aggregate tax burden from taxing a given investment has the effect of expropriating nearly all the value of an investment. Relatedly, even if there is not an express investment tax in place, as long as investment taxes are permissible, investors will expect that at some point the government will impose an expropriative tax that makes their investments nearly worthless. Either way, the papers suggest that unless the government promises not to tax investment income, it will heavily discourage investments.

Even in their heyday these theories rested on assumptions about how humans behave that seem at best questionable. Chamley and Judd, for instance, seem to rest their claims on the premise that savers today are not only able to foresee tax changes generations ahead, but that they care so deeply about those later generations that they will act today as if the tax burden fell on themselves. That is more of a science fiction movie than a starting point for serious tax policy (Batchelder 2009; Sanchirico 2021; Gibson 1984 is a prominent example in sci-fi literature). Auerbach (2006) offers a slightly more reasonable version of the argument, in which he essentially collapses it into the Atkinson and Stiglitz (1976) point: Even within a single lifetime, taxes on investments can add up to close to expropriative levels over several decades. But this, too, requires us to accept a view that taxpayers today think carefully about and fully internalize the tax results of their (much) later years, when there is considerable evidence they often do not (Shaviro 2007). Many individuals with large amounts of savings are also old, making the possibility of bad tax outcomes several decades in the future more of a hope than a worry.

For lower-earning households, the two models also assume another open question, which is whether taxes on investments in fact reduce investment. They might instead actually increase investment. Suppose taxpayers have some kind of target amount they are saving for—say, a set amount they want to leave their grandchildren to cover college tuition. In that case, the higher the tax, the more the target saver will need to sock away. Evidence on this point is quite mixed (Sanchirico 2012). With one notable exception I will return to later, however, it seems unlikely that these kinds of savings

targets will be important for households with enough riches to afford just about whatever they might desire.

Critiques of the Inefficiency Arguments

Even assuming that the inefficiency critiques rested on believable assumptions about human behavior, research over the last decade has largely undermined their key findings (Glogower 2018 also offers a helpful summary of research to that date). Indeed, there are now several powerful economic theories for why we should tax investments, at least the investments of the very rich.

Perhaps the most intuitive argument on this front is that we should tax households with great wealth because concentrated wealth and power deliver immense benefits to their holders while undermining autonomy and opportunity for everyone else, often alongside significant drags on economic growth. Chapter Two described the now-large empirical literature on these effects. These quantitative findings offer concrete support for the longstanding notion that concentrated wealth and power are public bads, like carbon dioxide emissions, only they pollute our politics and our economy instead of our air. They therefore should be taxed like other "negative externality" goods (Repetti 2001; Warren 1975; Hourani and Perret 2025; see Kopczuk 2013 for a description of this argument in the inheritance context). The fact that taxing the investment income of the mega-rich might also cause some economic distortions would lower the resulting tax rate, but probably not to zero (Warren 1975, 942-43; see Bovenberg and Goulder 2002 and Cremer, Gahvari, and Ladoux 1998 for general accounts of distortive taxes on externalities).

Another fairly intuitive argument for taxing ultrarich households is that their wealth marks them as having greater ability to pay than anyone else. Nearly every commentator agrees that all else equal, tax systems should put heavier burdens on households with a greater ability to pay. The difficulty is that once we announce that we are taxing the ability to pay, households will try to conceal their ability, such as by earning less than they are able (Atkinson and Stiglitz 1976). Ideally, we would want a tag of a household's underlying ability, which is hard for them to manipulate in response to the tax.

Emmanuel Saez and Stefanie Stantcheva argue that wealth accumulation is just such a tag. If taxpayers with greater inherent ability to earn have stronger preferences for savings, then it is efficient to tax them, because their savings decision reveals to the government that they likely have a greater ability to pay tax (2018). Saez and Stantcheva suggest this correlation is often the case for wealthy families. Families may value wealth for its own sake, such as the social status it provides them or the assurance that they will be able to establish a family dynasty that will continue for generations. Families with these preferences are apt to earn more, because they will invest their money

rather than consuming it all immediately. Empirically, there is a high degree of persistence in the returns to investment, even across generations (Fagereng et al. 2020; Nekoei and Seim 2023). Thus, taxing capital can be an efficient way to tag or target an individual's ability to pay.

Other arguments are more subtle or require a deeper dive into economic theory, but for the sake of comprehensiveness I will try to offer the highlights here. For example, Gamage (2014) argues that taxes on investment income can be efficient because they enable us to have lower tax rates on labor earnings: If we were to exempt savings from the income tax, we'd have to have a much higher tax rate on whatever is left in the tax base. In standard models, the economic damage of a tax rises exponentially with the tax rate, so that doubling the rate is more than twice as bad. Thus if we can split the tax base into separate pieces, imposing a lower rate on each, we should have a more efficient system overall.

A central premise of the Atkinson and Stiglitz (1976) paper and arguments following it, such as in Auerbach (2006), is that this splitting is impossible: A tax on what we save *also* discourages us from working for that money in the first place. But Gamage (2014) surveys evidence that in fact taxpayers usually respond to tax not by working less, but by hustling harder to find and exploit loopholes in the tax assessment and collection system. If labor taxes and taxes on investment are assessed and collected differently, then they can in fact operate as two separate systems where the splitting is possible. Galle, Gamage, and Kuchumova (2025) report evidence that this is true in the case of US sales tax and VATs in EU countries: Changes in rates at the cash register do not affect reported labor earnings. This implies that it is efficient for those two tax systems to split their tax collections between a labor income tax and the cash register charges. Similarly, Berriel and Jagadeesan (2025) argue that taxes on capital are efficient when individuals can mask consumption as business expenses.

Another relatively complex and nuanced theory for why it might be efficient to tax investment income comes from the self-styled "new dynamic public finance" (Golosov, Kocherlakota, and Tsyvinski 2003; Golosov and Tsyvinski 2015; see Hemel 2025 for a less math-intensive overview). Some economists have argued that even if taxing investments and inheritances changes the time when households choose to spend their money, that change is good because it encourages productivity. As Andrew Carnegie argued more than a century ago, wealthy heirs might be unproductive because their inherited wealth means they don't need to work to live comfortably (Saez and Stantcheva 2018; Straub and Werning 2020). On the other hand, wealth might increase labor supply, because it provides the capital needed to make work more productive (Golosov and Tsyvinski 2015).

Again, this might play out differently for the ultra-wealthy. In theory, either of these effects might dominate the other, making it uncertain whether we should tax or

perhaps even subsidize savings.[21] But it seems likely the Carnegie effect would be rather larger for those with great existing wealth. They have little marginal payoff to additional earnings—the top 0.1 percent consume about 30 percent of each new dollar they earn (Fox and Liscow 2025). And taxation, even at fairly high rates, is unlikely to affect their ability to pledge or use those existing assets to obtain financing.

A third set of nuanced arguments relate to what taxpayers expect the future to look like. Recall that the core argument against taxing investment income is that it makes future consumption more expensive than consuming in the present. In some understandings of Chamley and Judd, that problem is worsened by the likelihood that, if investment taxes are permissible, the government will at some point sharply increase rates. Critics have poked holes in Chamley and Judd's math (Straub and Werning 2020) and assumptions about government's ability to retroactively expropriate wealth (Saez and Stantcheva 2018). But there is another problem: Tax rates need not only go up. They might also drop sharply, as in the case of the repeated US tax "holiday" on repatriated dividends (Kleinbard 2016; Hemel 2019). In that case, future consumption could be *cheaper* than today's, which could actually encourage over-saving and asset lock-in (Brooks and Gamage 2023).

This is yet another scenario where the economics may be sharply different for the ultrarich. Dynastic wealth imparts political power. The very rich may well anticipate that they will be rather more likely to be able to extract tax holidays than to face unexpected wealth expropriation. The future always looks brighter when you control it (Piketty and Saez 2013; Straub and Werning 2020, 24). Compounding this, the likelihood of tax holidays could be said to actually be caused by wealth accumulation: The more wealth a family has, the more likely that they will have enough influence to extract a holiday. And then, having achieved that level of wealth, the family would defer consuming it until their next holiday. US political institutions, unfortunately, may tend to reinforce this dynamic.

Are Investment Earnings "Income"?

Several recent authors have offered what amounts to a descriptive rather than normative argument against taxing investment income: They say that most apparent changes in asset value do not enrich the owners (Aguiar, Moll, and Scheuer 2024; Sheffrin 2025). To reflect this supposed reality, the authors say, we should tax investments on a "cash flow" basis under which only sales of investments are taxed,

[21] Entrepreneurs can of course also seek outside capital, rather than relying on retained earnings. Therefore, wealth only adds to the productivity of labor to the extent that it is less costly as a financing source, relative to outside financing. This implicates many factors outside the tax system, such as the agency costs of outside financing (and the extent to which the legal system mitigates them), the opportunity cost of self-financing (using capital for business rather than consumption), and the risk preferences of the entrepreneur, which might in turn depend partly on applicable bankruptcy rules.

while new purchases generate deductions (Sheffrin 2025).[22] That structure is commonly called a cash flow consumption tax, and I detail its operations and many problems in the next chapter.

For now, it is worth pausing to note that these arguments are quite unpersuasive, notwithstanding some positive commentary from other quarters (Avi-Yonah 2025a). As Sheffrin (2025) notes, the new arguments are an elaboration of an old paper by John Whalley (1979), with some additional data on asset values. Whalley's article has no citations in Google Scholar except for those by the recent authors. Is it likely that the entire economics profession missed a fundamental issue so profound that it would transform the entire study of tax economics, only to have it unearthed nearly 50 years later? No, it is not.

While there are many conceptual problems with Whalley (1979), Sheffrin (2025), and Aguiar, Moll, and Scheuer (2024), for our purposes here it will mostly be sufficient to point out that each of the three analyses considers only a single taxpayer. In their models, a given household starts out holding an investment asset that pays a set annual return, as in the case of a bond or an annuity. Then interest rates in the economy fall, but the rate paid by the asset stays the same. This causes its price to rise: Now the household has a better investment than the other investments available in the rest of the market. Whalley (1979) argued that this price change should not result in greater taxable income for the owner. Even though one of the household's assets has increased in value, the household is now in effect poorer. If the household wants to save for future years, it will have to give up more consumption this year to do that, as it will now earn a lower rate on other investments.

Where this analysis goes off the rails is in failing to recognize that tax systems measure not absolute but relative well-being. Taxation is the system we have for deciding how to divide up the burdens of government. If something bad happens to *every* family, we cannot give them all a tax cut, because then who will pay for government services? Even if the social cost of funding government is higher in this suffering world—because the marginal utility of every family's dollar is higher—there will still likely be some families with more resources and others with less. Taxing those with more resources more heavily will still result in a lower total economic burden (assuming all else, such as the households' behavioral response to being taxed, is held equal). Tax burdens necessarily are always a proportional pie-slicing exercise, in which those who are doing *relatively* better should bear a larger share of the burden.

It's easy to see, once we add a second household to the simple Whalley (1979) story, why tax burdens for the household that holds premium bonds or an annuity paying above market rates should rise. Consider Example 4.1.

[22] Though none of the authors note it, their analysis also implies that borrowers would be taxed on borrowed cash proceeds, making their proposal fully equivalent to a CFCT.

Example 4.1

In period one, Bond Holder has $500,000 in cash and $500,000 in 10 percent coupon bonds with a term ending in period two. Daughter Cash Holder has $1 million in cash. Interest rates fall to 5 percent, causing the value of Bond's bonds to rise to about $525,000.

Scenario One: Spend half of period one resources immediately.

Bond spends $500,000 in period one and retains the bonds until period two. In period two he collects the interest and principal amounts and consumes $550,000.

Cash spends $500,000 in period one and purchases $500,000 of 5 percent coupon bonds. In period two she collects the interest and principal amounts and consumes $525,000.

Scenario Two: Save all resources for period two.

Bond spends $0 in period one. He purchases $500,000 of 5 percent coupon bonds. In period two he collects the interest and principal amounts of all his bonds and consumes $1,075,000.

Cash spends $0 in period one. She purchases $1 million in 5 percent coupon bonds. In period two she collects the interest and principal amounts and consumes $1,050,000.

Scenario Three: Spend all resources in period one.

Bond sells the bonds immediately and consumes $1,025,000.

Cash consumes $1 million.

Observation

In all three scenarios, Bond is better off than Cash. In present-value terms, Bond is always better off by exactly the amount by which the premium bonds increased in value.

In the example, there are two households, Bond and Cash, each with $1 million, who must divide their spending between two periods. Half of Bond's wealth is in the form of a bond paying interest through the next period. Then interest rates fall. Both can choose to spend anywhere between all and none of their resources in period one. Each household can instead save some money for the future, and can (without paying a broker fee, for simplicity) convert their cash into additional bonds paying the market rate. It turns out that no matter whether they each spend it all today or hoard it all until tomorrow, Bond's total consumption is higher than Cash's.

What is going on here is that though there is a common event that strikes both Bond and Cash, making savings less rewarding for them, Bond is better prepared to weather it because of his right to receive an above-market interest rate. If we have to allocate the tax burden between Bond and Cash, clearly Bond should bear a larger share. And that is evident no matter in which period, one or two, we measure their relative well-being.

To be sure, there are interesting conceptual issues here that have not received much attention in the tax literature, although they emerge occasionally in debates about national debts and the Social Security system (see Buchanan 2009 for an excellent overview). Suppose we widen our comparison from Bond and Cash to include later generations who may enjoy higher interest rate environments in which savings are more productive (but debts are more burdensome). How should we distribute the burdens of the ongoing national project between the Bond/Cash generation and those that follow? Would it be fair to allow Bond and Cash to debt-finance some of their consumption, and pass that burden on to their heirs, because the heirs will (per Whalley and the later authors) have higher lifetime utility? Perhaps, but it is not at all evident that the way to execute such a transfer is to exempt Bond's investment income, as that would still leave Bond with a higher marginal utility than Cash.

Similarly, the authors offer no real engagement with a long literature on consumption taxes, in which a key point of debate is to what extent tax systems should account for how families spread their money out over their lifetimes (compare, for example, Bankman and Weisbach 2006 with Shaviro 2007). Consumption tax advocates maintain that we should measure a household's marginal utility over a lifetime, so that it is perfectly acceptable for a family to pay no tax today but make up for it by paying a large tax late in life. That is a proposition with uncertain philosophical and even empirical support (Galle and Utset 2010).

But even accepting for the sake of argument that lifetime welfare should be the starting point for calculating tax burdens, we then have to grapple with the fact that different households may face different subjective costs of shifting funds between periods. At least arguably, those that encounter higher such costs have lower average lifetime utility, and so should face lower aggregate tax burdens (Shaviro 2007). Perhaps it is the

case that the market rate of interest is one such cost, but if so it's still not clear which way that cuts in terms of lifetime utility, depending on whether families are net borrowers or lenders. At a minimum, we should expect the new consumption tax advocates to explain why the one element of the cost of shifting funds that they focus on—an element apt to favor wealthy investors—should be the only such cost we take into account.

Concluding Thoughts

The economic argument for taxing the investment income of the ultrarich looks quite strong. Over the last decade, a variety of theoretical and empirical developments have undermined the older view, exemplified in Auerbach (2006), that tax systems should mostly avoid taxing at least the normal returns to capital. For several of those theories, there remain open data questions, such as the extent to which taxes on wages and investments overlap for tax-avoiding purposes, or whether taxing investment income on net encourages or discourages productive entrepreneurial activity. But we saw that there is rather less room for debate when each of these theories is applied to the ultrarich. In addition, newer research tends to confirm the longstanding intuition that wealth itself offers unique benefits and opportunities, whether formally spent or not. Still, to the extent that there is doubt, it is worth further asking: If we didn't tax investment income, what then? What would a tax system like that look like, and is it feasible to implement? I turn there next.

Chapter Five: Implementation Challenges of Consumption Taxes

• Whatever economic theory might say about taxing investment income, in the real world a tax system that leaves out the investment earnings of the rich would be deeply flawed.

• Taxes imposed at the cash register, such as a VAT, simply fail in the basic assignment of addressing top-end inequality. A VAT does burden the spending of the rich, but because the wealthiest households spend such a tiny share of their income, a VAT is a wealth tax only over the course of hundreds of years.

• Other approaches, such as the wage tax and CFCT, offer more progressivity, but economists who favor them have failed to recognize the fundamental legal obstacles both face.

• A wage tax has to distinguish compensation from investment, but that is a task that no global tax system in history has successfully managed. The only plausible legal approaches to resolving that problem raise similar constitutional issues as a wealth tax would.

• A CFCT has to distinguish investment from consumption, but that task is impossible legally and even conceptually in a country such as ours, in which the wealthy can earn huge consumption value from the mere possession of wealth. A CFCT also faces dual constitution questions, related to whether imputed income and borrowing are constitutional "income."

• Proposals to tax wealthy households when they borrow also face a constitutional question about whether borrowing can be taxed, as well as practical questions of implementation.

Chapter Four argued that there is a strong theoretical case for taxing investment income, at least for the very wealthy, but acknowledged that there is still room for debate and further research. We now turn to a more practical question: Even assuming that there were good theory reasons for leaving aside investment income, how could that work in practice? If we don't tax investment income, we are left with taxes on labor alone (what I'll call a labor or wage tax), or taxes imposed on what households buy, known as consumption taxes. These can come in a variety of forms, with somewhat different policy advantages and disadvantages to each, as prior influential commentators have explained.

I argue that none of the major wage or consumption tax proposals, standing alone, can give us a satisfactory tax system. In the aftermath of *Moore*, some proponents have argued that constitutional limits on the ability of a tax system to reach investment income might be an additional reason to favor taxes on wages or consumption (Avi-Yonah 2024). That is, perhaps all the options are flawed in one sense or another, but at least wage and consumption taxes are more clearly legal. In fact, though, the best versions of a wage or consumption tax also face serious constitutional questions.

Value-Added Taxes

Every country in the world, except the US, imposes a VAT. The VAT resembles the US retail sales tax, but it allows retailers to take a deduction for the costs of their inventory. For example, a retailer who sells $5 million worth of products but paid $4 million to acquire that product would be taxed on $1 million in net sales. VATs are typically imposed only on domestic sales, so that while imports are taxed on their net value, exports are not.

A VAT can be a reasonably effective component of a fair tax system, as thoroughly explored in a careful review by a blue-ribbon UK commission in 2011 (Adam et al. 2011). As I explained in Chapter Four, it can be efficient to replace some income tax revenue with a retail consumption tax, because (up to a point) that substitution can swap out highly distortive top income rates for relatively less distortive and lower-rate VAT charges (Brooks, Galle, and Maher 2018; Galle, Gamage, and Kuchumova 2025). While that could be true of any tax imposed at the register rather than the payroll, VATs outperform the simpler retail sales tax because they avoid multiple layers of tax on business inputs, and incentivize each party in the supply chain to report transactions, facilitating enforcement. This efficiency case is easier to make if the VAT treats all consumption equally, such as by fully taxing services and essentials, though that is uncommon in global VAT systems.

Many countries struggle with a VAT's regressivity. Obviously, a retail tax tends to tax lower earners at a higher effective rate, because lower-earning households consume a much larger share of their income.[23] A VAT also likely has to charge the same tax rate for all human purchasers, a "flat" rate that again falls more heavily on those with lower

[23] It could be argued that this inequality tends to even out over the course of a person's lifetime, as they pay a high rate during lean times but a low rate during their best earning periods. Households in theory could use borrowing and saving to smooth out these differences. But these kinds of lifetime utility measures ignore important economic and even philosophical considerations, such as the likelihood that most low earners do not actually have the ability to borrow or save readily (Shaviro 2007; Galle and Utset 2010).

ability to pay.[24] Many nations respond to these pressures by exempting household essentials such as meals. Again, it's well known this is a poor choice (Adam et al. 2011). Among other reasons, the benefit can be claimed by higher-earning households as well, and it shifts every household's purchases toward the tax-favored options. Tax lawyers also know painfully well that, because these exemptions are basically arbitrary, there is no good way to decide borderline cases. Are marshmallows "food"? Is an artfully-arranged bouquet of flowers a taxable good or an exempt service?

A more appealing approach is to pair a VAT with rebates or other offsetting spending, so that the net effect of taxing and spending is overall progressive. For example, the Nordic model in which a broad-based VAT is paired with progressive social spending may well be more efficient than the US federal income tax without losing much overall progressivity through the middle of the income distribution (Kleinbard 2016). A VAT could be combined with cash rebates for lower earners (Gale 2020; Graetz 2008), or used to fund a universal basic income (Auerbach 2006). Timing mismatches between when VAT is collected and when refunds are paid can be important for lower-earning households and would need careful design to get right (Galle and Utset 2010).

Admittedly, a VAT is a complex and expensive tool if the only thing it accomplishes, after accounting for refunds, is to bring in revenue from higher earners. Enforcement and compliance costs can exceed 5 percent of VAT revenue (Berhan and Jenkins 2005). Graetz's plan aims for overall simplification, and reduction in compliance costs, by exempting households earning under $100,000 (in 2008 dollars) entirely from the income tax. But our contemporary American devotion to means-testing, ranging from the Earned Income Tax Credit to health-care subsidies to student loans, probably makes that idea unachievable, or at best makes the gains minimal because the compliance burden of measuring "income" will just shift to these other programs. The possibility of pairing a VAT with a suite of universal benefits that do not depend on income seems close to utopian.

More urgently for this project, and contrary to some influential commentary, a VAT likely cannot meaningfully address massive inequality at the top because it does not raise much money from the wealthiest taxpayers. Auerbach (2006) argues that, if we accept the arguments of the macroeconomist Christophe Chamley (1986), we can view

[24] Some retail-based tax systems have attempted to exempt or give discounted rates to low-income buyers, but it is doubtful these efforts could scale readily. For example, in the US, purchasers who utilize a Supplemental Nutrition Assistance Program (SNAP) payment card are exempt from retail sales tax on eligible purchases. But funds on the SNAP card are quite limited. If governments issued favored households an ID card to grant VAT exemption more generally, there would be a strong incentive to sell or gift use of the card. This incentive is not present with SNAP because each use depletes the SNAP benefit. It also is not clear how to integrate buyer exemption with seller deductions; conceivably, sellers could be limited to deducting only a pro rata share of their expenses. Perhaps a more viable option would be to allow buyers to seek refunds separately. This is detailed more in the main text.

a newly enacted retail consumption tax, such as a VAT, as a kind of wealth tax. Over time, a VAT will hit the entire store of existing wealth as that wealth is spent.

The difficulty is that the very wealthy consume a quite small fraction of their wealth during their own lifetime. Estimates are that the ultra-wealthy consume only something like thirty cents of every additional dollar they earn (Fox and Liscow 2025). A VAT is thus a wealth tax only over the course of centuries. That is no problem for Chamley, whose model assumes that families are like Greek gods: infinitely lived and possessed of power to perfectly anticipate future tax changes. But it means that outside Olympus a VAT is not an effective tool for redistribution at the very top of the distribution, as Auerbach (2006) acknowledges.

The ultra-wealthy may also expose an important gap in even the most broad-based VAT system. In the broadest existing VAT systems, such as in Canada and New Zealand, VAT falls on retail services as well as goods. But as we saw in Chapter Two, US wealth offers routes to power and personal satisfaction without any express transactions or purchases—even if one counted campaign contributions as taxable transactions. In technical economic lingo, wealth is "in the utility function" for the wealthy, even with zero identifiable consumption as such. That has two key implications, both bad. For one, it means that a VAT will be even more regressive, because it will tax the ways that most households use their money, but fail to tax the unique influence that the very wealthiest can wield without spending. And it means that the wealthy will prefer influence over outright expenditures, since influence is not taxed. Thus, not only would a VAT fail to redistribute wealth at the top, but it would also push wealthy households to use their wealth for their own aggrandizement.

My point is therefore not that a VAT has no important tax policy uses, but rather that it is not an effective tool for achieving redistribution at the top of the income range, and hence for addressing the core of modern inequality. Indeed, not only does VAT fail to change the distribution of wealth among the very rich, it also fails the supposed premise of a consumption tax, which is to leave taxpayers indifferent between spending and saving. A VAT could actually bend some top households toward further accumulation.

The Wage Tax

Wage or "labor income" taxes offer a potential alternative path to a VAT for advocates of consumption taxes. Suppose every dollar a household earns is either spent (consumed) or saved. If so, Henry Simons famously argued, an income tax is just the sum of a tax on consumption plus a tax on savings (1938). With a little algebra, it's easy to then show that a tax on labor income—all income, minus income from savings—is a tax on consumption. We'll see that this equivalence turns on some key assumptions that are

not always satisfied. For now, though, think of a wage tax as a way of taxing consumption through households' paychecks, rather than at the register.

A key advantage of collecting a consumption tax through paychecks is that the wage tax is much easier to implement with progressive rates. That is the central design element in the "X tax" proposal from David Bradford, later further developed in Carroll and Viard (2012).[25] That is, a wage tax can be made to look just like the familiar income tax, but with an exemption for savings and investment. The wage tax could make use of tools an income tax uses for achieving progressivity, such as personal deductions, rising rates at higher income amounts, and so on. These features would make the wage tax potentially much more progressive than a VAT alone.

At first glance a wage tax also looks to have constitutional advantages over systems that might seek to tax investment returns. After all, if the Constitution limits "income" to mean realized income, there seems little doubt that salary paid to laborers is realized, the "fruit" of any "tree" of business profits (in *Macomber*'s awkward agricultural metaphor).

Defining "Wages": Economic and Legal Problems

This basic case in favor of the wage tax falls apart because it can be quite challenging to identify when labor income is actually paid, as we now know from more than 100 years of experience.[26] Carried interest is the famous example, but there are many others. In a typical carried interest arrangement, an investment fund manager selects investments for clients, and receives in exchange a right to a share (often 20 percent) of any resulting profits (or profits in excess of some threshold return, such as 8 percent). If all these events transpired in one year, we'd have little difficulty concluding that the profits payments should be taxed as labor income. Current US doctrine instead treats the entire profits interest as an investment asset of the manager, taxable only at capital gains rates and only when the fund eventually realizes gains.

Another version of the same problem is the loophole in the social security payroll tax base for self-employed individuals. The social security tax is almost a perfect wage tax, imposed on "remuneration for employment" (IRC § 3121[a]). But self-employed

[25] Carroll and Viard (2012, 34-35) also refer to their proposal as a "real-based" X tax, to distinguish it from a CFCT, which they call either a real-plus-financial tax or a personal expenditure tax. Auerbach (2006) calls these instruments an "R tax" and an "R+F tax," respectively. As the names imply, the "real" tax ignores financial flows such as borrowing and interest, while the R+F tax takes account of these flows as if they were no different than other sources of cash. I call the "real-based" X tax or R tax a "wage tax." I dub the R+F tax a "CFCT."

[26] Wage-type taxes also offer a set of unique avoidance and arbitrage opportunities in addition to the basic question of what is a "wage." Although these have been known and potential government responses discussed for a long time (e.g., Schutte and Shome 1993), it is unclear how effective the anti-abuse rules would prove in reality.

individuals can avoid it by paying out their business earnings as distributions of profits rather than salary. Tax law in theory treats at least a minimal portion of an entrepreneur's profits as a "reasonable" salary, but commentators all generally agree that that regime does not currently work. Less famous, but equally challenging for the legal system, are bubbling controversies about how to treat various forms of separation payments, such as golden parachutes.

A third prominent set of examples center around various forms of deferred compensation arrangements, such as stock options, "supplemental executive retirement plans," and life insurance policies with large embedded investment components. Broadly speaking, these schemes allow workers who do not need immediate cash to convert some of their compensation income into various forms of investment asset, getting the benefits of tax deferral and often a lower tax rate to boot. Individuals who work for themselves always have the option to simply leave wage earnings inside the firm and harvest them through sale of the firm's equity.

How and when to tax these kinds of earnings is already a fairly agonizing problem under an income tax, where the stakes are relatively low, and a wage tax worsens the problem. With an income tax, the issue is mostly about the appropriate timing and rate to apply. Under a wage tax, though, classifying a payment as investment rather than wages results in full exemption, making each decision more valuable to the taxpayer and costlier for the government. That about guarantees that taxpayers would work even harder to reclassify wages as investments, and that both sides would sink more into resolving each dispute.

As other commentators have recognized (e.g., Saez and Stantcheva 2018), this definitional problem suggests that a wage tax likely fails in its basic aspiration to achieve neutrality. Just as under an income tax, households will see a tax advantage if they can be paid later, and if they can hold off selling "investment" assets longer.[27] Everyone will want to earn (or claim that they have earned) "investment" opportunities, not salary. And by widening the tax wedge between wages and investment even wider than under the income tax, the wage tax encourages even more wasteful and distortive tax planning. For instance, there is reportedly a life insurance policy for one US chief executive in excess of $250 million. I studied the economics of executive compensation for 18 months at the Securities and Exchange Commission (SEC). If there exists any theory for why life insurance is an efficient tool for incentivizing managers to maximize firm value, neither I nor the SEC economists I worked with have ever heard it.

[27] That is, even though wage-tax proponents say that it ignores sales of financial assets, in practice the wage tax would likely have to treat the sale of assets acquired by work as compensation at the time of a realization event, as in the case of carried interest.

Wage Taxes and the Constitution

The definitional problem also undermines what looked like a solid constitutional argument in favor of a wage tax. Again, it seems straightforward that a cash salary is realized income. But the legal rules for a wage tax regime cannot only tax cash on receipt, because then eventually a larger and larger share of the economy would shift away from cash salary into investments and "investments." Many potential legal responses to this problem would run quickly into constitutional *terra incognita*.

To see this, consider the very simple rule courts apply to efforts by the self-employed to evade the social security payroll tax. As I mentioned, the IRS has occasionally succeeded in arguing that an individual whose business earns substantial profit, but who reports no wage income, should be deemed instead to have earned a "reasonable" salary. Usually what is reasonable is measured by looking at other similar businesses. But no cash has actually changed hands. Has the entrepreneur realized income, in the constitutional sense, when they have no fruit, only tree?

Though there is a constitutional shortcut here in some cases, that shortcut will likely fail for many others. As we saw earlier, the Court faced a quite similar question in *Moore*, and resolved it by holding that the realized income of the business could be attributed to the individual investor. That is all well and mostly good for business owners. Presumably the Social Security "reasonable salary" approach would be constitutional under the same attribution theory with which the Court upheld the MRT, though it might run aground in years in which the underlying business lost money. What, though, about Shohei Ohtani, whose $700 million contract with the Dodgers defers 90 percent of the payments until 2034? What of CEOs who own no part of their company, but instead stand to profit from "restricted stock units" that replicate the economics (but not governance rights) of an investment in the company? Could a wage-tax system treat any of these promises as wages in a year before they were paid?

To be clear, my argument is not that taxing Shohei or restricted-stock units prior to full payment is certainly unconstitutional, but rather that these are precisely the same issues that confront a tax on non-compensatory investment income. Simply exempting investment income, or offering deductions for savings, does nothing to mitigate the constitutional challenge, because taxpayers will constantly press the boundaries of the legal definition of "savings" in ways that will demand something other than a simplistic response. There will be enormous pressure to effectively subject many forms of compensation to MtM treatment, for the same reason that today there is pressure to subject all other investments to that treatment. While some of these approaches might survive as narrow anti-abuse rules, that path is inherently uncertain, as the borders of what is permissibly narrow seem entirely within the Court's discretion. The Constitution is not a reason to move toward a wage tax.

Other Wage-Tax Weak Points

This horse already looks dead, but before moving on let's note a few other ways that wage taxes can fail to achieve their neutrality goals. For one, merely exempting investment returns from the tax base does not necessarily make a household indifferent about whether to consume today or tomorrow. Consider what we might call a "staged labor" project in which the output of an initial labor effort can either be consumed immediately, or instead used to complete a second stage. With traditional cost-recovery methods, the entrepreneur will not deduct these reinvested funds until the final product is sold. In this case, taxing both the first- and second-stage profits produces the same differential tax rate on consumption as taxing pure "capital" would.[28]

Further, as this example illustrates, for labor projects there is an analog to the lock-in problem, in which the entrepreneur can save tax by selling only a final good, rather than selling each of the individual stages. While asset lock-in typically does not last as long for manufacturers as investors, it produces additional distortions at the boundary of the firm. Groups of entrepreneurs can achieve tax deferral by consolidating production inside one entity, so that collectively they are producing only a final good rather than a set of intermediate stages.

A final flaw, or at least an ambiguity, in a wage tax is its apparent omission of windfalls (McCaffery and Hines 2010). Taxpayers may rarely find cash on the street,[29] but they do win tort awards or lotteries, receive lump-sum termination payments, and inherit wealth—sometimes vast wealth—from relatives. All of these should likely be taxed under a so-called "wage tax," because none of them affect the timing of when the recipient individual chooses to spend or save (I reserve more detailed discussion of possible effects on the bequeathing relative for Chapter Six). If we left these kinds of receipts outside the tax base, we would need to impose a higher and therefore more distortionary rate on wages.

In sum, a wage tax has many unappealing economic features and no redeeming constitutional advantages. To be sure, the most sophisticated versions of a wage tax shore up some of its economic weak spots by combining it with other taxes. The X tax, for instance, adds on a cash flow business tax. But while adding another tax might offer some complementary economic features, the wage tax component remains a wage tax, with all the legal challenges and resulting tax distortions that defining "wages" brings.

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[28] This problem can be mitigated if entrepreneurial laborers use a business entity to conduct their business. Several wage tax proposals, such as the X tax, include a complementary cash flow tax imposed at the business level. As we will see in the next subpart, a cash flow tax should eliminate timing distortions resulting from staged labor at the business level.

[29] This author did once find a $20 bill lying on the street in Philadelphia.

A CFCT

A third option for taxing consumption is the cash flow consumption tax (CFCT).[30] A CFCT starts with the traditional income tax base, but the taxpayer can take a full deduction for all unconsumed funds, such as purchases of investment assets. The individual is then taxed on all later gross receipts from the sale or use of the investment (Andrews 1974, 1149). This is the sense in which the tax is based on "cash flow": All dollars out—other than those used for immediate consumption—reduce tax while all dollars in increase it. Cash flow includes borrowed funds, which the debtor must include in their tax base.[31] The debtor then receives a deduction for any subsequent interest and principal payments.

Even though a CFCT appears to eventually tax investment earnings, the allowance for an upfront deduction has the economic effect of making the effective tax rate on some of those earnings zero. Allowing immediate deductions for all investment expenditures is often known as "expensing." As I explain in more detail in the margin, expensing is a mistake: It rewards taxpayers who buy equipment instead of renting by granting them deductions immediately, rather than over time.[32] Under certain assumptions, the value of this excess reward exactly equals the tax burden imposed on average returns to

[30] Carroll and Viard (2012) call this a personal expenditure or "real plus financial" tax, while Auerbach (2006) calls it "R+F." McCaffery and Hines (2010, 1043–44) call it a "spending tax."

[31] Andrews (1974, 1150) proposed that for simplicity there would neither be income nor deductions for short-term consumer debt, which today would presumably include credit card balances.

[32] Imagine that Effie, a taxpayer from our Example Family, runs a French restaurant and needs to keep her cheeses cold. She has two main options. First, she might rent a refrigerator, or rent space in one from a neighboring business. If so, then each year Effie will have a deduction in the amount of the rent she pays. Alternatively, Effie might purchase the refrigerator. Assume that the purchase price of the refrigerator is exactly equal to the discounted present value of the stream of rental payments the buyer would otherwise incur. If that is true, then, tax aside, Effie is indifferent between buying and renting.

When should Effie receive a deduction for the cost of buying the refrigerator? In order to keep her indifferent between the two options, the answer must be that each year, Effie should receive a partial deduction, in the amount of the annual rental cost of cooling services. Under our assumption that the purchase price is the present value of those expected rental costs, this means that Effie's annual deduction can just be the purchase price, divided by the number of years she expects the refrigerator to last (I am eliding here some wrinkles involving the time value of money). Thus expensing is "wrong" because it produces tax results more favorable for purchases than for the alternative of renting.

capital.[33] Two tax wrongs then make a right (for consumption tax advocates): Through expensing, a CFCT imposes no net tax on investment returns.

But a CFCT does not exempt super-normal returns, sometimes called "economic rents," such as from monopoly patent rights. This differential treatment is usually presented as an attractive feature of a CFCT. Taxes on rents are thought to be highly efficient, perhaps more efficient than taxes on labor, because they have relatively smaller impact on real economic decisions (Auerbach 2006). By definition, the taxpayer cannot earn super-normal returns through other choices, so taxes are less likely to affect the decision to seek rents. If Effie can earn a 3 percent return normally, or 10 percent by investing in MonopolyCo, it would take a very large tax to get her to abandon her MonopolyCo position.

Arguments for CFCT over Wage Tax

A CFCT solves several of the problems of a wage tax. For one, a CFCT does not have to distinguish between wages and capital, which as we saw is also one of the key weak points of the modern income tax. Since all unconsumed funds are omitted from the tax base at the end of a year, a CFCT in effect gives every worker an unlimited IRA or tax-favored pension in which their compensation, in whatever form, can be tax-deferred as long as it is unspent. A CFCT therefore also does not need to rely on approximations of wage income that might be subjected to constitutional challenge.

A CFCT also gets closer to making taxpayers neutral about when to spend their money. As we saw, a wage tax imposes a higher effective tax rate on what I called "staged labor," much as a traditional income tax would. A CFCT avoids this effect, and its resulting potential distortions, by allowing all outlays to be deducted immediately, whether or not a project is complete. A CFCT also mitigates the related distortion at the boundary of the firm, because it allows the maker to claim deductions for the cost of making intermediate-stage goods, whether those goods are used by the maker or instead sold to another producer.

On the other hand, a CFCT can still distort timing decisions (Carroll and Viard 2012, 32). If our entrepreneur expects to earn a greater return than the "normal" return (i.e., the interest they will pay on any borrowing), they will still face a higher effective tax rate on

[33] Assume that Effie, from the last footnote, faces a 20 percent tax rate, and buys a $500 refrigerator. With a full immediate deduction, Effie will have an extra $100 in her pocket. She can then invest this money in her next best ("marginal") investment. Suppose that the available opportunities in the economy pay 10 percent. She'll earn $10 per year as a result of expensing.

Now further suppose that Effie's restaurant business does not perform better than other available investments, and produces a 10 percent return on investment. Her $500 purchase of a refrigerator thus yields an added $50 in cheese revenue. At a 20 percent tax rate, she will face $10 in annual tax. This is exactly the extra amount that she gained from expensing the refrigerator, yielding a net after-tax rate of 0 percent.

staged projects and deferred consumption: By paying sooner, they give up the opportunity to earn rents. Most models of a cash flow tax assume away this possibility by positing that an investor will have already maximized their available investment in rents, so that the next investment opportunity available at the margin will only return the economy-wide average (e.g., Kleinbard 2016). It is unclear whether this assumption is really true. Investors face significant obstacles to scaling up investments, even investments that are expected to produce super-normal returns. For example, because of the inherent economic problems involved in operating a business with someone else's money, many promising new technologies struggle to find financing. The tax benefit offered by a CFCT is a kind of government-provided financing that might allow investments in rents to be further scaled up.[34]

It's similarly debatable whether a CFCT can cure workers' incentives to characterize their earnings as investments, not wages. Under a CFCT, a worker who received compensation in the form of an equity interest in a business would have income, but would also get an immediate offsetting deduction in the amount of their new investment, for a net tax of zero (Andrews 1974, 1153). The worker would then have income when the equity interest was later sold. Andrews argued that this deferral opportunity was not valuable because the inside buildup of the equity interest would also be taxed at sale (Andrews 1974, 1150). That presumes that all deferred gains will be taxed eventually, contrary to our current basis step-up at death regime.[35] Similarly, as we saw in Chapter Three, deferral may create option value for taxpayers who might push for or anticipate future rate changes.

Defining "Consumption": Economic and Legal Challenges

Despite these possible advantages over a wage tax, a CFCT also has several debilitating weak points and a good handful of smaller but troublesome question marks. As with the wage tax, the biggest weaknesses end up being a stew of legal boundary drawing, economic distortions that follow from the boundary difficulties, and then constitutional constraints on what the legal system can do in response.

The most important of these challenges is a CFCT's limited ability to distinguish consumption from investment. In our modern economy, owners of durable assets often get consumption value from what they own, as in the classic example of a homeowner who gets to live rent-free on a property. If a CFCT allows deductions for purchases of assets that provide consumption value, it will fail in its basic mission, because it will be

[34] As this example suggests, it's not clear whether on average a CFCT moves total investment closer to or farther away from the optimal amount of capital investment. A CFCT distorts investment choices for rentiers, but also may solve a market failure in the financing of rent-bearing projects.
[35] Under current law, in many cases investments earned as compensation are taxed at death, because the deferred-compensation statute treats death as a realization event. *See* IRC § 83.

favoring current purchases over later purchase of consumption services, and favoring some kinds of consumption (those that can be delivered through durables) over others.

Cash flow taxes can tackle this issue one of two basic ways. One is by denying deductions for purchases that will provide consumption value. The other is that a CFCT could allow a deduction initially but then include the consumption value of the asset in income each year (Andrews 1974, 1150, 1155).[36] Neither of these approaches works well.

Let's back up to first get a clearer picture of why a CFCT has to pick one of these two. Suppose that Effie buys ApplianceCo bonds. A CFCT would give her an immediate deduction in the amount of their purchase price. What if she instead buys an ApplianceCo refrigerator, with an expected useful life of 10 years? In a sense, the refrigerator isn't much different than the bond: Durable goods are a form of savings. What Effie has purchased is 10 years' worth of future food-cooling services.

But a CFTC should not provide a deduction for Effie's refrigerator purchase, assuming she is keeping it in her kitchen at home, rather than using it in, say, a restaurant business. We want to tax her consumption, and so Effie should not be permitted to deduct purchases that provide her with consumption value. She would not get a deduction for the costs of renting an at-home refrigerator, no matter when she paid for it.[37] So, too, she cannot get a deduction for buying the fridge, even though it will last beyond the current taxable year. Giving her an immediate deduction for buying the fridge would be the equivalent, in present-value terms, of giving her a deduction each year for her consumption of personal cooling services.

Another way to look at the transaction is as if the refrigerator were actually a savings account, where the money in the account is withdrawn each year to pay rent. In that case, the CFTC would give her a deduction in the year she puts her money on ice with ApplianceCo. But then each year, as she gradually withdraws those funds to pay ApplianceCo for annual refrigeration services, she would have to include the withdrawal as cash flow income.

This concept of taxing the rental value of property the taxpayer owns is sometimes known as "imputed income," and has a long and politically fraught history in the US. In our imaginary alternative transaction, the tax on Effie's annual withdrawals is easy to

[36] Andrews (1974, 1155–56) also suggests a kind of third option in the case of debt-financed consumer durables: ignoring both the loan proceeds and the interest payments. He argues that taxing the household on funds used to make annual interest payments would then be the equivalent of taxing the imputed income from the durable.

[37] Prepaid rent is a bit more complicated. In reality what's happened there is two transactions. First, Effie has put money into a savings account. Then, she later withdraws the money from the account to pay rent. If we wanted, we could reconstruct these two implicit steps for tax purposes, giving her a deduction when the rent is prepaid, and then an income inclusion when the rental period occurs and funds are in effect withdrawn from the account. I discuss this latter possibility shortly.

calculate. Each year Effie's bank statement would show a withdrawal of a certain number of dollars, and a payment of that amount in satisfaction of a rental agreement that specified an annual rent. In the real world, though, Effie buys a refrigerator, and we don't necessarily know what the annual rental value might be.

What if we did neither of these, but simply allowed Effie to claim deductions for her refrigerator, her home, or indeed the cost of any asset lasting more than a year? Dollars consumed this year would not be deducted; dollars spent this year for consumption next year would be. In that case, we would be offering Effie a powerful incentive to change what and when she consumes—just the opposite of what a CFCT is supposed to accomplish.

Contrary to the suggestion in Andrews (1974, 1159), this is not just a small side-problem with refrigerators or vacation homes. In an important sense, many of the most valuable assets in our economy provide substantial consumption value in later years. Andrews (1974) focuses, somewhat dismissively, on rare works of art or collectibles that the owner takes pride and pleasure in displaying. Yet as Chapter Two describes in more detail, US wealth accumulation today opens the door to many avenues of social control—the power to get what you want. For instance, media companies, whether traditional or social, can be instruments for advancing the owner's ideological goals. If nothing else, great wealth offers its holders the opportunity to take satisfaction from the ability to transmit dynastic wealth and power, a lasting family legacy, to future generations.

Thus, rather than making taxpayers indifferent between spending today and tomorrow, a CFCT arguably over-corrects. By ignoring the imputed income from wealth, a CFCT excessively rewards accumulations that deliver these kinds of intangible benefits to their owners. Recent US experience suggests that massive accumulations of wealth and power by a handful of persons with outlier political views have become a central social problem that needs remedying, not worsening.

Once we see that the scope of the imputed income problem is so vast and pervasive, the simple response of denying deductions for durable assets with consumption value no longer seems plausible. When nearly any asset seemingly can offer great consumption value if accumulated and deployed strategically, then it becomes unclear conceptually how we would categorize some goods as "consumption" and others as "investment."

Admittedly, these kinds of "utility from wealth" effects might be hallmarks mostly of great wealth, not the everyday savings working households can hold in their retirement accounts. If so, it may follow that a CFTC would apply different rules to different taxpayers. Households with fortunes large enough to grant power over their surroundings today, or the ability to transmit dynastic control, should face a different

set of rules, one in which their wealth accumulations are not exempt from tax. In a sense that regime could resemble the modern structure of the federal income tax. For the most part in our system, modest amounts of retirement savings are taxed only on a cash flow basis, as in the traditional IRA, which allows a deduction for contributions with an income inclusion for distributions. In contrast, large accumulations and intergenerational transmissions of wealth are taxed, or would be, if not for the realization rule.

On a more pedestrian level, any effort to allow deductions for investment assets but not personal property confronts a CFCT designer with evidentiary and administrative challenges an income tax drafter need not face.[38] To be sure, income taxes also distinguish between business and personal use. But the stakes there are relatively low for many assets, in that the difference is only important when the asset is sold for a loss.[39] A CFCT must correctly allocate every asset, or risk significantly distorting the markets for some goods. The income tax also has the advantage of being able to draw on evidence from an individual taxpayer's particular usage of an item over time, while a CFCT has to assign products to categories at the time of purchase.[40] It also is unclear how a CFCT would deal with assets that regularly switch categories, such as a home that is sometimes rented out and sometimes not.

Education costs are a good example of the kind of good for which these evidentiary questions would likely be thorny. The income tax today has a set of rules, crafted entirely by the IRS without much congressional input, detailing which costs can be deducted (26 CFR § 1.162-5). Those rules are a hopeless morass of unclear distinctions between personal and business, present and future. Perhaps eliminating the question of present expense versus capital expenditure (i.e., investment) would help matters. Fundamentally, though, we know that people get an education for a mix of reasons. A degree that looks practical today might prove mostly recreational tomorrow, and vice-versa. I am not aware of any serious CFCT proposal that has attempted to address

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[38] A helpful consideration of real-world experiences with a CFCT in India during the 1960s is Kelley (1970).
[39] Andrews (1974, 1160) argues that a theoretically ideal income tax would also have to identify and tax imputed income from durable assets. Perhaps. But the entire premise of switching to a CFCT is to eliminate tax distortions of when households choose to consume. If it cannot achieve that, then the undesirable distributive effects and higher rates of a CFCT—relative to our imperfect current income tax—are hard to justify.
[40] Conceivably, though, a CFCT could have some sort of corrective device for mis-assigned property, such as an income-inclusion rule, perhaps with an extra interest charge, for property that was initially categorized as an investment but later turned out to be used for consumption. How such a rule could practically be implemented is unclear. In an income tax, taxpayers and third parties typically report sales for losses. Taxpayers, at least, have an incentive to report annual expenses related to property used for profit. A CFCT with corrective income inclusions would need some mechanism for periodically reporting and reassessing how a taxpayer is using a supposedly investment property. That means that the tax authority would need an inventory of every major asset each taxpayer owned and had previously claimed a deduction for. Perhaps an alternative would be to impose the recapture tax and interest charge at resale, if any.

how educational expenditures should be treated, and one suspects that this is because the problem has no ready answer.[41]

It appears, then, that a CFCT would struggle to distinguish investment from consumption at the time of purchase, but this leaves the possibility of imposing annual taxes on imputed income. American scholars regularly describe taxing imputed income as impractical or politically impossible, but it's not quite clear why. Many other countries taxed imputed income from housing at the dawn of the US income tax, and Wisconsin's forerunner state income tax did so as well. Taxes on imputed income from housing remain a fairly common global feature today (CASE n.d.).

A simple and roughly accurate imputed-income system would just be the mirror image of what we do today for depreciation. That is, because the purchase price of a consumption good generally should reflect the discounted value of the flow of future consumption, we might take the purchase price of the asset, and spread that price out over the expected life of the asset, with an adjustment for the time value of money. Andrews (1974, 1157) notes that this simple method may fail for long-lived assets, where interest rates or usage value may change during the life of the asset. Taxes on imputed income also pose similar liquidity issues as a tax on unrealized gain. But those are often fairly easy problems to overcome (Galle, Gamage, and Shanske 2023), as I discuss more in Chapter Seven.

CFCT and the Constitution

Unfortunately, an annual tax on imputed income faces constitutional questions under present law similar to those that would face a wealth tax. Indeed, perhaps the strongest argument against the constitutionality of a tax on imputed income is that in form and operation the two are relatively interchangeable. Imagine that the Court were to hold that taxes on imputed income were within the scope of the 16th Amendment. It would then be fairly easy for architects of a wealth tax to draft a bill that achieves their goals but labels the resulting tax as imposed on the "imputed income" from a broad class of assets. As we have seen, they could even make a plausible argument that simple financial assets create imputed income in large enough accumulations. This ready equivalence suggests that courts that are hostile to a wealth tax are unlikely to be more welcoming of taxing imputed income.

Precedent and available historical materials probably leave courts with the room to hold that imputed income is not "income" within the meaning of the 16th Amendment. Again in *Eisner v. Macomber*, the Court said that income has to comprise "something of exchangeable value proceeding from property, severed from the capital . . . and

[41] For example, the terms "education" and "human capital" do not appear anywhere in the Meade Committee report.

received by the recipient for his separate use, benefit, and disposal." It is unclear whether courts would say that the intangible consumption benefits arising from mere ownership—the satisfaction of owning a rare painting, say—are "severed" from the underlying property or "received by the recipient for his *separate* use." After all, by definition imputed income comes from owning the thing, and can't be separated from that ownership.

The Court would later seemingly disavow *Macomber*'s reliance on the "severance" metaphor, but it's unclear whether its revised definition is friendlier to imputed income. In the case of *Helvering v. Bruun*, the Court decided that a taxpayer had income from the expiration of a lease, where the tenant had improved the rental parcel during the tenancy. It rejected an earlier lower-court opinion by the famed judge Learned Hand, in which Judge Hand argued that such improvements were not taxable because not "severable" from the underlying property. (See *Hewitt Realty Co. v. Comm'r*: 884). Stanley Surrey, famously, believed the *Bruun* decision implied that realization was dead as a constitutional principle (Surrey 1940, 783, 791).

Unfortunately, it seems at least four current justices, and maybe six, do not share Surrey's reading, leaving us to have to guess what they believe is left of *Macomber* today. The plaintiffs in *Moore* argued that *Bruun* also noted that income in that case arose "as a result of a business transaction": the cancellation of the lease. In at least one previous case, the Court said, it had found income from a "profit realized in the completion of a transaction." What this tells us about realization is uncertain. We know that a transaction (whatever that is) can sometimes be sufficient to create realized income, but not whether it is necessary. Assuming it were necessary, as the *Moore* plaintiffs asserted, there would be some doubt about whether simply residing in a house or gazing upon a favorite artwork could be described as a "transaction." "Non-material satisfactions," the Court has said (albeit when interpreting the Code, not the Constitution), "are not taxable as income" (*Helvering v. Stuart*: 168).

There is also probably room for debate about whether the Supreme Court would agree that broadly taxing imputed income is consistent with the original public meaning of the 16th Amendment. Again, the state of Wisconsin and a number of countries taxed imputed income from a personal residence at the time the 16th Amendment was being ratified by the states. In my view, this is evidence that the original public meaning of "income" included unrealized income, and thus that *Macomber* was wrong to say that "income" is limited to realized gains. Suppose, though, that five justices disagree with my view. What would they make of the historical evidence? Perhaps they would simply conclude that imputed income is realized, which would be a good result for CFCT proponents. The justices might, however, also assert that the original meaning of "income" generally requires realization, and that imputed income is unrealized, but that there is a narrow exception to the realization rule for owner-occupied housing (maybe on the grounds that the status of imputed income from housing as realized or

unrealized was unsettled in 1913). That seems an unprincipled claim but one that, as a predictive matter, is hard to rule out as a possible outcome.

Nor is imputed income the only constitutional vulnerability for a CFCT. Recall that a CFCT tax base includes borrowed funds. Borrowers must be taxed because the combination of expensing and tax-free borrowing offers taxpayers a return on leveraged investments that is actually better after tax—a lesson the OBBBA authors conveniently ignored (Andrews 1974, 1127, 1138–39, 1154). That is, without a tax on borrowed funds, a CFCT would distort consumption and investment choices, favoring investment over consumption and encouraging debt over equity or retained earnings. That of course defeats the whole point of using a CFCT.

It's uncertain, though, whether the Court would see borrowing as a realization event. Traditionally, the US income tax system has not treated borrowing as income, at least when the borrower and lender have agreed on a binding commitment to repay: "When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. Because of this obligation, the loan proceeds do not qualify as income to the taxpayer" (*Comm'r v. Tufts*: 307; *see also id.* at 319 [O'Connor, J., concurring]). The rule that borrowing is not income is longstanding, though seemingly based on "the meaning of section [62]," not necessarily the Constitution (*Comm'r v. Wilcox*: 408). Still, challengers to a rule taxing borrowing could cite this language at least as shedding some light on the constitutional meaning of "income" (*Cf. James v. United States*:249–53) (Whittaker, J., dissenting) (arguing that the 16th Amendment does not permit taxation of borrowers until the time that they fail to repay).

Historically, the exclusion for borrowing seems to have grown out of courts' struggle to reconcile an annual income tax with the reality that the ultimate economic outcome of a transaction might be unresolved by the end of the tax year. In the first decade or so of the individual income tax, courts seemed to suggest that borrowing was not taxed because it was uncertain whether the borrower would get to keep the proceeds or instead would have to repay. (E.g., *Indep. Brewing of Co. of Pittsburgh v. Comm'r*:874). That was the grounds on which the Supreme Court would initially say that embezzlers did not have taxable income (*Wilcox*:408). In his dissent to *Wilcox*, Justice Harold Burton pointed out that there was also a line of cases in which taxpayers were taxed immediately, even though they faced some risk of having to make a future repayment (*Wilcox*:415). Burton would eventually prevail, as a decade later the Court held that the decision to impose tax before a final resolution of the underlying repayment obligation was an administrative choice open to Congress and the IRS to resolve, and thus that extortioners can be taxed, despite the likelihood they may be caught and forced to repay (*Rutkin v. United States*). As the dissenters noted, that result effectively overruled *Wilcox*, and the Court made that overruling official in the subsequent *James* case.

Three justices—Whittaker, Black, and Douglas—dissented from the *James* decision. They argued that embezzlers were like debtors, and that the Court had always at least implicitly treated debts as outside the constitutional definition of income. (*James*: 250–52, 255–57). In particular, they claimed that cases treating canceled debts as income only made sense if there was an underlying rule in which the initial debt was not taxable.

The *James* dissenters are not persuasive. It's true that we wouldn't need a rule taxing cancellations of debt if the debts themselves were taxed, but that doesn't mean that both rules have to be part of the 16th Amendment definition of income. Instead, we can think of the cancellation of indebtedness cases as answering the question, "Supposing that there were a rule of administrative convenience that ignored initial borrowing, would it be constitutional to trigger tax at the time of a later transaction in which that debt were canceled?" Further, even if it were true that borrowed funds are not 16th Amendment "income," taxes on them still would not have to be apportioned. Recall that only "direct" taxes are limited by the Constitution; excises and other "indirect" taxes do not have to be apportioned. A tax on bond issuances or other new debt looks like a classic excise tax: a government upcharge on the sale of a financial instrument, though in the case of a CFCT collected from the buyer (Fox and Liscow 2024, 654).

My point then is not that a CFCT would certainly be unconstitutional, but instead that there is at least a meaningful amount of risk that courts might see it that way. While *Rutkin* and *James* strongly suggest that borrowing can constitutionally be taxed, there is no case that holds that directly. Skeptical judges could cite the standard language about why debts are not part of statutory income, and could lean on the *James* dissenters for their constitutional rationale. They might distinguish *Rutkin* by saying that criminals who help themselves to someone else's money are in a different position than borrowers in a consensual relation to the creditor (though it's unclear exactly why consent matters from a tax perspective).[42] And they might respond to the excise tax argument by noting that a true excise tax would not have rates that vary with the purchaser's income (though in other cases the Court has said that taking income into account does not by itself make a tax an income tax).

CFCT or Wage Tax Revisited

Lastly, a CFCT has some features that disadvantage it relative to a wage tax, but leave it on roughly the same footing as an income tax. Like the income tax, a CFCT depends on the legal mechanisms of the realization rule to determine when taxpayers have to include cash flow in income. In contrast, a wage tax can (mostly) ignore investment transactions, except to the extent that those transactions are actually wages in disguise.

[42] The Second Circuit took a similar route in its own treatment of embezzlement (*Collins v. Comm'r*).

As we saw in Chapter Three, enforcing the realization rule in the world of modern financial markets is complex, uncertain, and apt to leave loopholes for the savvy and well-resourced taxpayer. Perhaps, though, a CFCT would close off some common strategies for deferring tax on gains from sale, such as installment sales or prepaid forwards. Those strategies depend on treating a sale as a loan for tax purposes, and so would probably result in immediate tax under a CFCT. And perhaps a CFCT would lower the stakes for these kinds of games, as while the payoffs to deferral are not zero, they are less certain.

Another difference between wage taxes and a CFCT that other commentators have sometimes emphasized is the way in which a CFCT can fail to be time-neutral under a progressive rate structure. As Warren (1975, 945), Auerbach (2006), and Kleinbard (2016) point out, a CFCT can impose a higher tax burden on savings than on present consumption if rates rise in the years in between when the household buys an investment property and sells it. A $100 deduction at a 20 percent rate does not generate enough cash flow to offset a later 30 percent tax on that investment. Progressive rates make this kind of rate mismatch more likely, as in the case where a household has higher income in the year that it sells. Indeed, McCaffery (2005) argues that this is a desirable feature of a CFCT, because families with growing wealth should be those we most want to tax. By comparison, the rate structure is mostly irrelevant to whether a wage tax is time-neutral, since the wage tax just ignores investments whether bought or sold.

This feature is of lesser interest for a tax system aimed exclusively at the very rich. Extremely wealthy households will likely be in the top tax bracket every year, so their marginal tax rate won't usually change. For those families, a CFCT therefore will not serve McCaffrey's goal of distinguishing real increases in household lifetime wealth from income-smoothing savings. Where the difference does still have bite is the possibility of legislative changes in the rate structure. A wage tax leaves households mostly indifferent about the path of future rates (again setting aside investments taxed as wages in disguise, and except to the extent that households must plan today for their future labor earnings). A household that faces a CFCT, on the other hand, is still quite sensitive to what rates will be in the future, as rate cuts will hand them a net subsidy on their investments, while rate increases will impose a positive net tax burden. If this possible tension between tax holidays and tax expropriation is a high-order concern, a wage tax might be preferable (Auerbach 2006).

Finally, a wage tax might be preferable to a CFCT from the perspective of new dynamic public finance. Golosov, Kocherlakota, and Tsyvinski (2003) argue that entrepreneurial activity should get more favorable tax treatment than normal economic returns. The idea is basically that entrepreneurial activity is riskier, but provides positive spillovers in the economy. Taxing the entrepreneur's outside option can be a way of encouraging

them to stick with the risky activity. A CFCT does roughly the opposite, exempting the normal return to capital while taxing the super-normal returns that are sometimes the result of entrepreneurial efforts.

Ultimately, although there are certainly some trade-offs, a CFCT is probably the best of the comprehensive consumption tax proposals. It at least solves the fundamental legal puzzle that wage taxes pose. And yet it still faces deep and uncertain legal challenges of its own. It probably would have to tax both imputed income and borrowing, yet both of those routes have serious constitutional doubts.

Borrowing as Realization

A smaller addition to the consumption tax menu would be to treat borrowing as itself a realization event within the standard realization-based income tax (Andrews 1974, 1137). That route was recently floated by Sen. Warner, and developed in detail by Fox and Liscow (2024). Briefly, the idea is that a household with untaxed built-in gain would have to treat that gain as if it were realized to the extent of their new borrowing each year, with certain *de minimis* exceptions. As Fox and Liscow (2024, 653) note, their approach is similar to a CFCT in that wealthy households can use borrowing to consume unsold assets, so that taxing at the time of borrowing might do a better job of matching taxable income to actual consumption choices.

While the proposal is worth exploring, it's unlikely to offer a meaningful route to addressing high-end inequality.[43] Most simply, it doesn't raise much money—about $5 billion per year on average (2024, 650–51), for a net increase in effective tax rates of about 0.2 percentage points, from 12 to 12.2 percent (Fox and Liscow 2025, 15). Though the extremely wealthy can choose to realize a relatively small share of their income (about half for the top 0.1 percent, for example), it turns out that even that share is vast enough that they seldom have need for additional spending (Fox and Liscow 2025). In this sense the borrowing proposal goes wrong by aiming taxation at the portion of high-end wealth that arguably has the highest marginal utility: the portion that wealthy families actually consume. Under conventional marginal-utility analysis, a rich family's stock of unconsumed wealth has even lower marginal utility than the wealth they spent, because it yielded the wealthy family no direct utility at all. All else equal, this unconsumed wealth should be the priority target for taxation.

[43] A fully fleshed-out proposal would probably need additional loophole closers, some of them with uncertain prospects for successful implementation. A tax on individual borrowing would put a lot of pressure on the use of business entities, such as partnerships or trusts, to acquire assets and then make those assets available for free use by an individual owner or beneficiary. While in theory the first is a constructive partnership distribution, that is hard to police, and use of trust-owned assets may have no current applicable tax consequences at all. Similarly, current gift tax rules allow children to borrow with a guarantee by their parents, often secured by parental assets, without any resulting gift tax liability for the parent. I am unaware of any serious effort to address the role of guarantees in the income or transfer tax systems.

Like a CFCT's borrowing provisions, the borrowing-as-realization proposal also faces constitutional questions. Defenders might argue that loan funds look like an asset "separate from" the underlying property, consistent with *Macomber*'s arboreal metaphor (Fox and Liscow 2024, 654). The worry would be that a court would counter that the funds come bundled with an offsetting obligation to repay, so that, much as with the stock split in *Macomber*, the taxpayer has no net change in their economic position. And, as I discussed above, it may be more difficult to convince courts that a tax on borrowing is an "excise" for which the 16th Amendment is irrelevant when the tax is only imposed to the extent that the borrower has unrealized income.

Concluding Thoughts

Over the course of two chapters, we've considered whether it's good, actually, that the US tax system mostly fails to reach large accumulations of wealth. The overwhelming conclusion is the opposite. As a matter of economic theory, investment income should be taxed, especially for the very wealthiest Americans. And even if that argument were somewhat uncertain (which it doesn't seem to be), there isn't any practical route to taxing only consumption that would still address the fundamental problem of massive top-end inequality. If anything, we've seen that starting from the logic of a cash flow consumption tax, we quickly end up with a tax system that in fact would impose annual taxes on the holdings of the ultrarich.

Chapter Six: How Should Intergenerational Transfers Be Taxed?

• There is a compelling economic case for taxing massive inheritances more heavily than other investment income.

• Contrary to some prior commentary, massive inheritances should be taxed, not subsidized, because multi-generational control of policy and the economy demoralizes most individuals and saps economic growth.

• Fiscal systems should tax both the investment income of the present generation and the massive inheritances of the next.

• Legal systems around the globe struggle to collect taxes imposed as a result of death, whether on investment income or inheritance.

• Key legal tools for avoiding taxes at death include trusts and estate "freezes," in which a wealthy donor pays a small tax immediately to escape a much larger tax at death.

• In the US, massive amounts of wealth, likely in excess of $5 trillion, are now held in trusts that are permanently exempt from any form of estate or inheritance tax.

Current Law

Income Tax. Gifts and inheritances are not income for the recipient. For the transferor, neither death nor gift counts as a realization event that would trigger tax on any built-in gains in transferred assets. Heirs get a new basis in inherited property, equal to the fair market value of the asset at the time of death; this is the "basis step-up at death" rule.[44] Taxpayers who get gifts during the lifetime of the giver instead get "carryover" basis, which is to say they have the same basis as the transferor.

Transfer Tax. Forty percent tax on lifetime transfers and bequests for estates in excess of the exemption amount, currently $30 million for married couples. Transfers to a spouse are not taxed. Assets held in trust are not taxed as a result of the death of the original grantor, unless the trust meets a legal test for inclusion in the estate (which is based on the grantor's degree of control over the trust). In the case, however, of assets

[44] In community property states, marital assets receive a full step-up at the death of the first-dying spouse, while in other states those assets receive only a 50 percent step-up.

held in trust for long periods, a generation-skipping transfer (GST) tax also imposed at a 40 percent rate may apply when funds are distributed to beneficiaries. Trusts may be partially or fully exempt from a GST tax, depending on whether the value of assets contributed to the trust were below the GST exemption amount at the time of contribution.

Discussion

Up to this point we've covered the taxation of investment income for living investors, but many commentators view life and death differently. For most, there is a stronger argument for taxing accumulated wealth when it is inherited than when it is still in the hands of those who garnered it. Thus, for example, Andrews (1974), Auerbach (2006), and Adam et al. (2011) resist most taxes on the ordinary return to investing but endorse much broader taxes at death. An important contrary view is Louis Kaplow, who argues for exempting gifts and bequests as a way to encourage altruistic transfers (Kaplow 2010). Because most of this debate is already surveyed thoroughly in Kopczuk (2013), my coverage can be relatively brief, with an emphasis on new insights available once we recognize the strong possibility that wealth accumulation is a value in its own right for those who can achieve it.

Again, I argue that the implications of the existing literature are quite different when we focus on the relatively small group of the very wealthiest households, those that can command what we might think of as "dynastic" wealth. For example, while Kaplow's arguments might hold some appeal for small everyday gifts among friends, they are unpersuasive when intra-family transfers give wealthy heirs unfair opportunities to dominate public policy in ways that are not remotely open to anyone else.

I then play out these basic analyses for several key policy questions related to transfers at death. In particular, I argue that death should not wipe out the tax burden associated with a household's lifetime investment gains, that heirs should have to include inheritances in their own income, and that both of these rules can and should be applied in tandem.

None of these points are especially controversial, and yet they are very far from where we are in current law. Infamously, the basis step-up at death rule wipes out all lifetime investment gains. Though in theory we have an estate tax system for the largest bequests, that system has more holes than a woodpecker's favorite telephone pole. To set the stage for my reform proposals in Chapter Nine, I describe what's gone wrong in some detail. We cannot simply repeal the basis step-up, or substitute a new inheritance tax for the broken estate tax, without closing off the many modern gaps that busy tax planners have pecked in the existing system.

Is Death Different?

The case for taxing inheritances starts with the very basics: We should tax households with greater ability to pay more, and it's hard to see why accessions (a term I use to include both inheritances and gifts during the life of the giver) don't contribute to a household's ability to pay tax. To be sure, in-kind transfers are often harder to value, and may come with liquidity concerns. Though some transfers, such as household services, pose somewhat complex policy questions about the nature of a tax system, those issues do not arise for the large transfers of cash, financial instruments, and business interests that are our focus here.[45] Valuation and liquidity concerns could be mitigated with standard deferral strategies, such as allowing the recipient to delay income until realization, but with a zero basis in the transferred asset.

The standard counterargument is that taxing inheritances would be, in effect, a tax on the donor's savings. If Effie pays a wage tax when she earns money, and her heirs also pay an inheritance tax on what she leaves them, then Effie will be more inclined to spend money herself than bequeath it. Even assuming Effie values her children's well-being equally to her own, she still prefers consuming her earnings herself because that way they are taxed only once. Of course, we have seen over the last two chapters the many short-fallings of that simple double-tax argument.

But there is also a strong argument that we should tax wealth transferred at death, even if we have a general policy against taxing other investments (Batchelder 2009; Kopczuk 2013). Assuming that it makes sense to tax capital at all (a condition that lawmakers presumably believe holds now, given current law), it will generally be preferable to impose at least a small incremental tax on inherited wealth. If the tax rates on accessions and capital gains are equal, it is usually more efficient to raise the rate on accessions than the rate imposed on all capital. Even if capital gains taxes are at their revenue-maximizing rate, an additional tax on accessions is likely to raise additional revenue.

Taxes at death should be higher both because they cause fewer economic burdens than taxes on the living and because massive inheritances are worse for society than massive wealth enjoyed by one generation alone. Let's start with the economic burdens.

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[45] For example, the gratuitous receipt of nontransferable services may not reflect much, if any, change in a taxpayer's ability to pay tax. Likewise, a taxpayer who receives transfers in kind, or is gifted cash that is restricted to narrow purposes, may not experience a change in the marginal utility of wealth to the full extent of the fair market value of the transfer. But a rule that simply exempted in-kind or restricted transfers would be easy to manipulate, as the two sides of the transaction could always arrange to substitute the exempted item for cash. This general rationale also explains why tax systems treat barter as a realization event. That substitution response is relatively unlikely for intra-household services, though, so we could at least safely carve those out of any "accessions" definition.

Obviously, the dead tell no tax tales. The question is whether the expectation of a tax at death will affect how potential transferors behave during their lives.

Almost by definition, in order for a tax at death to matter during a transferor's lifetime, it must be the case that the transferor cares about the after-tax resources that they are able to leave to their heirs. Some individuals may give no thought to heirs at all. Evidence suggests that half or more of all inherited dollars are left behind accidentally—for instance, because the individual was saving for end-of-life care, and then died earlier than expected (De Nardi et al. 2025; Kopczuk 2013). If so, taxing bequests would be highly efficient. Think of the famous tax case *Cesarini*, in which the taxpayers found $4,500 in a used piano (*US v. Cesarini*). What is the optimal rate of tax on cash found in a piano? It may be close to 100 percent: The piano purchasers would not have changed their behavior based on the found-cash tax, and neither would the piano sellers. So, too, with accidental bequests.

Accidental bequests are sometimes thought to be mostly the byproduct of household savings for retirement, a largely middle-class phenomenon (De Nardi et al. 2025), but there are other possible causes that could encompass even ultra-wealthy families. We have seen, for example, that wealth accumulation is an avenue to power and influence, and that often it serves that purpose better when held than when spent. Commentators have interpreted the massive bequests of the rich as likely evidence of their high degree of concern for later generations (Kopczuk 2013), but if wealth accumulation can serve the private purposes of earlier generations in this way, it seems equally possible that even these dynasty-founding inheritances are an unintended side effect of efforts to amass influence during life. Parents may also accumulate wealth to encourage care and attention from their children (for evidence, see Fahle 2025) and it is unclear how inheritance tax would affect this motive.

More generally, even for families that plan to leave an estate, it is uncertain how much they care about the after-tax benefits they leave, as opposed to the gross estate. For instance, most families divide estates equally between children (Fahle 2025), despite the possibility that children will end up with unequal shares after tax (as in the case where assets grow after inheritance and the children are in different tax brackets). Thus, on average, it appears that savings behavior is less responsive to taxes at death than during life. For example, Kopczuk and Slemrod (2003) find that a 10 percent increase in the tax rate on inheritances reduces capital accumulation by about 1 to 2 percent. Similarly, most savers are "not risk-averse over bequests" (Lockwood 2018). In addition, while some households may respond to an accessions tax by reducing their efforts to earn capital, others likely respond with tax-minimization strategies, such as trusts, that may not affect capital gains realizations during life (see Gamage 2014 for more discussion).

On the benefits side, taxing large inheritances may achieve some additional policy aims that even investment taxes imposed during life might not, such as by reducing

inequality of opportunity. In the model of Piketty, Saez, and Zucman (2023) and Piketty and Saez (2013), society may want to help equalize family outcomes between those whose parents desired and achieved significant investments for their heirs, and those whose parents did not. Inheritance taxes may also mitigate the tendency of inherited wealth to reduce heirs' labor supply (Golosov and Tsyvinski 2015; Tasar and Voorheis 2025), but we do not have good evidence on whether this effect differs from other taxes on savings. One possible data point here is that family-owned businesses strongly under-perform once the founding generation passes, and economies with more family control grow more slowly, as we saw in Chapter Two. That could also be an independent reason to tax bequests, at least of concentrated business ownership positions (Batchelder 2020).

Putting the point a slightly different way, the case for taxing massive accumulations of wealth and power might be even more urgent when that accumulation will be passed from generation to generation. Dynastic power offends our belief in an open, meritocratic society where all families have reasonably equal opportunities, and it robs many in later generations of their fair chance to compete and set their own priorities. Inheritance taxes pass these public costs on to the private persons who create them (Kopczuk 2013). And to the extent that dreams of dynasty motivate massive accumulations in the first place, taxing them might discourage those kinds of excess.

Taxes or Subsidies?

In contrast to this view that we should tax inheritances even if most investments are exempt, Kaplow (2010) argues that bequests should be tax-exempt whatever our views on taxing capital. The basic structure of Kaplow's argument is that gifts create more utility than other forms of consumption, and so should be subsidized. Suppose that giving is an act of consumption for Jim: He derives utility from making the recipient better off, or he derives utility from others observing his generosity, or some combination of the two. If Jim buys himself a watch for $100, he gets $100 worth of consumption (presumably). If he instead gives Della a set of combs, he might derive $60 in utility, while Della also receives $100, a $160 total. To encourage Jim to take Della's well-being further into account, Kaplow suggests, we should give Jim a $100 subsidy, so that he fully internalizes all her benefits as well as his own.

Even taken on its own terms, this internalization story is a wobbly basis for exempting bequests. Much depends on the exact structure of Jim's preferences. If Jim fully internalizes Della's after-tax resources, subsidies are wasteful and may result in

excessive transfers.[46] Alternatively, if Jim does not fully account for Della's well-being, exemption for Della is an ineffective tool for influencing Jim's behavior; this is one reason why we encourage charitable giving with a deduction for the donor, instead.[47] Yet even for the charitable contribution deduction, evidence is mixed on whether on average the subsidy results in even a dollar of new charity for every dollar spent on subsidy (e.g., Galle 2016). Jim's transfers to Della also may be an accident, which Kaplow acknowledges would undermine his argument.

Further, this charming story of watches and combs might hold for small everyday gifts, and even for some inheritances, but no longer persuades when what is transferred is dynastic wealth and power. Dynasts' gifts might provide the donors a warm glow and the recipients wealth and power, but that benefit would be swamped by the losses of everyone else. Almost by definition, concentrated economic and political power is zero-sum, or worse: If dynasts are able to exert power, others in society have lost it. In a society that permits unlimited transfers of dynastic power, dynasts may be happier, but everyone else will be demoralized by the understanding that their own descendants will be subject to the preferences of the dynasts. Also, by definition dynastic power is valuable because it gives the recipients the ability to achieve policy goals that they could not achieve with their votes alone: It empowers a wealthy minority. Transmittal of dynastic power, then, will typically reduce social welfare, as the voting majority of families will lose power in the future. As a result, even if Kaplow's analysis makes sense for relatively small quotidian gift-giving, it does not extend to the case of vast inherited fortunes.

We might also essentially ignore the preferences of the very wealthiest households because of the very low marginal utility of money of their heirs (Kopczuk 2013; Saez and Stantcheva 2018). That is, a prospective dynast is unlikely to get any more utility from leaving their heirs $1.01 billion than they would get from leaving behind $1 billion. Further, the larger the bequest, the more likely it is that funds will not be consumed for several generations, and of course that is especially so in the case of dynasty trusts that deliberately limit distributions in order to preserve the family nest egg (Madoff 2010).

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[46] In Kaplow's typical account of subsidies, these kinds of inefficacies do not matter, as long as one key—likely unrealistic—assumption is met. To simplify a bit, Kaplow (2010) assumes that all subsidies are "distributionally neutral," which is to say that the full cost of a subsidy is paid for through lump-sum taxes on the class of households that benefit: Bequests would be subsidized but the rich would face much higher income tax burdens. Households that receive an average subsidy level thus neither gain nor lose, but each household still has an incentive to engage in more subsidized activities. Since all subsidies are fully paid for, their cost efficacy does not matter. As Kaplow acknowledges, these pay-fors are usually not implemented in reality, so that a planner who wants to encourage bequests (without paying for that subsidy through distribution-neutral offsets) must be willing to accept the distributional and inefficiency consequences.

[47] Gifts are not deductible from a normative ability-to-pay tax base because the choice to transfer wealth to another is itself a decision by the donor to consume that wealth in a particular way. That is, prior to giving the gift, an individual who has $1 million to give away has a greater ability to pay tax than the individual who does not.

While we do not have good evidence on the extent to which dynastic planners discount future expenditures, nearly all humans have a "discount factor" in which they prefer earlier to later consumption, if for no other reason than the time value of money. Accordingly, we might again think that the marginal dollar added to a dynastic bequest would have almost zero utility for the dynast, because even if they value the consumption of their heirs, the marginal dollar will go to heirs so distant that the present value of the distant heirs' consumption is very low.

There's a potential counterargument here, but it ends up ultimately supporting inheritance taxes. The counter would be that, in fact, would-be dynasts can have quite high marginal utility, because dynasties are difficult to establish. Suppose that there is some rough minimum threshold of wealth that families need to achieve in order for a dynasty to be viable. Maybe below this level, risks that heirs will spend profligately, or that assets will fall in value, make it quite possible that the dynasty well runs dry in a generation or two. If that were so, there would be rising marginal utility for would-be dynasts as their wealth builds up to this key threshold point. Yet if this were true, then it is likely we would still want to tax dynasties quite heavily, because it would imply that there is a powerful income effect. If we taxed dynastic wealth, families below the threshold would be motivated to work harder and save more in order to reach the threshold.

Another possible counterargument to the critique of Kaplow could be that accessions taxes would actually exacerbate political influence by the wealthiest. Some authors claim that the threat of a future tax would encourage wealthy households to spend their money rather than saving it, and that one of the things households would purchase would be political influence (Bankman and Weisbach 2006; McCaffery 1994). If this were so, efforts to use accessions tax to mitigate dynastic power might be turned on their heads.

But because political influence today simply is not the same as political influence tomorrow, the commentators' argument goes wrong in its apparent claim that transfer taxes can only shift the timing of dynasties' political power without reducing it. Political influence is not like a spare refrigerator that can be kept in the garage; it must be renewed (Jacobson 2015). Further, there are likely diminishing returns to political spending in any given period—for example, because very large expenditures are hard to conceal and generate blowback for the recipient officials (Wood and Grose 2022). Investments themselves—savings, rather than spending—can be sources of political influence (Repetti 2008). And of course taxes reduce the total resources available to the dynasty. Therefore, even if the commentators are right that transfer taxes shift political spending earlier in time, taxes are very likely to reduce a dynasty's influence, particularly in the later time periods that are the central concern of my proposal.

Lastly, it's doubtful the commentators' suggestion that more direct methods for limiting political influence, such as campaign finance reform, could by themselves constrain the power of billionaire dynasties. For one thing, as we have already seen, vast wealth and business holdings offer an array of means of social influence far beyond the scope of what can realistically be regulated through lobbying or campaign contribution limits. Moreover, campaign finance law, like other regulatory regimes, is subject to influence and gaming (Kang 2012). Reducing the resources available to dynasties through a transfer tax may diminish their capacity for bending campaign finance rules to their own ends (Wallace 2023).

Death and Whose Taxes?: The Basis Step-Up and the Estate Tax

So far in this chapter I've laid out arguments for taxing inherited wealth, but how do those arguments relate to my earlier claim that we should also tax investment income? Under an MtM tax system, those questions are almost entirely separate. Investment gains will be taxed each year as they happen, and inheritances would be taxed separately. However, what if we instead have a realization-based system in which individuals may die before selling their appreciated property? Then we need to decide whether to treat death as a realization event, and if so how it meshes with an inheritance tax. Again, under current US law death is not a realization event, and even better, heirs receive a "stepped-up" basis in inherited assets so that they owe no tax on gains that accumulated during the transferor's life.

In a system where we are taxing capital gains when they are realized—that is, under current law—there is a strong argument for repealing the basis step-up rule, assuming that we had a good replacement available. If transferors care about the after-tax value they can pass along, basis step-up incentivizes would-be transferors to hold assets until death, contributing to the lock-in problem, as Example 6.1 illustrates:

Example 6.1

Roberta Plantini holds $100 million in stock of the Stairway Company with basis zero. If Plantini sells the shares before death, she will owe $23 million in tax, leaving $77 million for heirs. If Plantini holds the shares until death, allowing heirs to sell for $100 million, they will receive all $100 million after tax, because their basis is also $100 million.

This rationale for repeal is roughly the mirror image of the argument against taxing capital income I described in Chapter Four. That is, consumption tax supporters assert

that a tax on investments distorts the taxpayer's decision about when to consume, by making future consumption subject to a heavier tax than current consumption. Similarly, here, the argument is that basis step-up makes it cheaper for the family to consume during the heirs' generation than during the donor's. This argument is thus subject to many of the same counterpoints I raised with respect to the consumption tax. For example, some individuals might not care about their heirs, or might care only for reasons that are unrelated to the exact amount of after-tax value they can pass on (for example, if bequests are mostly symbolic). To the extent that individuals are indifferent to heirs' after-tax receipts, basis step-up probably does not contribute to lock-in, but in that case economists would likely say that it is optimal to impose a substantial tax on inheritances, as we saw earlier in this chapter.

There is an argument that wiping away capital gains just for inherited property is a good thing, but that position is tenuous. Suppose that we thought the main distortion of a capital tax is that it increases the cost of consumption during an heir's generation relative to the generation when the capital is created and appreciates.[48] Basis step-up eliminates this effect, while preserving capital taxation of assets used for consumption during the founding generation's lifespan. That's an odd combination of results. It probably requires us to think that earners care more about the after-tax resources of future generations than about their own future selves (or that taste for and returns on lifetime savings are correlated with earning ability, but taste for and returns on intergenerational savings are not).[49] The marginal effect of higher capital gains rates in Canada, where there is deemed realization at death, is actually to increase realizations, which researchers attribute to an income effect (Lavecchia and Tazhitdinova 2024). Since that result fits better with the theory that savers favor their own consumption over that of heirs, it would tend to suggest we should not wipe out capital gains at death.

Commentators have not to date considered closely how taxing accessions should relate with a repeal of basis step-up at death. There are some situations in which one of the policies is justifiable but the other is not. For example, if most bequests are accidental, then there is a strong economic basis for the accessions tax (because exemption would not increase bequests) but somewhat weaker economic grounding for repeal of basis step-up (because there would not be much lock-in). But with the existing state of the evidence, in which many but not most bequests are accidental, we have a situation in which basis step-up causes lock-in but the subsidy case for exemption is still fairly weak.

To some voters, implementing both an accessions tax and step-up repeal may look like a double tax—say, if death is a realization event for the decedent and also triggers the

[48] This is how some commentators interpret the Chamley-Judd model (Auerbach 2006).
[49] See Chapter Four for an explanation of why taste for and return on savings matters to whether we should tax investment earnings.

inheritance tax. But this is not really so (IFS 2010, 364). Instead, the deemed realization simply leaves heirs with the same result they would have obtained if the donor had sold their appreciated property during life, then bequeathed the after-tax proceeds, as Examples 6.2 and 6.3 illustrate. That is, deemed realization is collecting the tax that the donor had the ability to pay (the asset's accumulation during the donor's life), while the inheritance tax is collecting the tax that the heirs have the ability to pay, which is reduced by the tax paid by the donor.

Example 6.2: Inheritance Tax with Basis Step-Up

Suppose that inheritances are taxable at long-term capital gains rates. The facts are otherwise the same as 6.1. If Plantini sells $100 million shares with $0 basis during life, she retains $77 million after tax. When the heirs inherit these funds, they pay additional tax of $17.71 million, leaving about $59.3 million after tax. If instead Plantini holds the shares until death, then heirs sell immediately afterwards, the heirs will pay $23 million in tax and retain $77 million after tax. Compared to 6.1, the difference between selling and bequeathing the Stairway Company stock has narrowed from $23 million to $18 million—that is, the difference is only 77 percent of the difference when there is no inheritance tax.

Example 6.3: Inheritance Tax with Deemed Realization at Death

Same facts as 6.2, but there is deemed realization at death as well as an inheritance tax. If Plantini sells during life, heirs receive $59.3 million, net of their inheritance tax. What if instead Plantini holds the shares until death, and then heirs sell afterwards? Then there is a $23 million tax on Plantini's estate at the time of Plantini's death. Assuming (as under the current estate tax) that this tax obligation is deductible from the amount of inheritance taxed to heirs, only the remaining $77 million is taxed to heirs, leaving them with $59.3 million. The heirs receive the same net-of-tax amount regardless of whether Plantini sells or bequeaths the shares.

Another possible effect of collecting both sets of taxes at the time of the death is that it might put an added burden on liquidity-constrained households. In other words, heirs might be more likely to have to sell off family farms or businesses to pay the two sets of tax bills. As Batchelder (2009, 2020) and Graetz and Shapiro (2011) have explained, there is no evidence that estate taxes ever really cause these kinds of fire sales. There are many planning steps families can take, such as buying life insurance, that would

mitigate the hazard in any event. But on the other hand, we also have never had both an estate tax and a deemed realization at death in the United States.

A potential advantage of a wealth or MtM tax, then, is that we would not have to juggle the interaction of two systems both triggering tax at death. Because under these two alternatives investments of the older generation have already been taxed to the older generation, we do not need death as a trigger. That avoids the appearance of a double tax that might hit small family businesses especially hard.

Tax regimes that do not allow basis step-up usually use one of two alternatives. In Canada, both death and gifts during life are treated as realization events; gifts (but not bequests) have sometimes been realization events in the UK and Australia. The US has twice tried but failed to implement the second alternative, which is to give heirs carryover basis, as if they had received the bequest during the transferor's life. Implementing carryover basis is certainly more complex, especially under the 2010 plan to grant each heir a $1.3 million upward basis adjustment across all assets (see Zelenak 1993 for a meticulous examination of the details). It is worth mentioning, though, that the main complaint against carryover basis has been the supposed difficulty of tracking basis across generations, a task that Canada has managed with little controversy (Zelenak 1993). Modern innovations in financial reporting of basis, combined with exemptions for low-value personal property and rules for approximating basis with purchase-period value, would make implementation even easier. But carryover basis has the serious disadvantage that it still permits indefinite deferral of gains by the heir generation. Revenue scores for realization at death have usually been four times or more as large as for carryover basis.

Implementation Obstacles to Reform of Intergenerational Transfers

While there is a solid economic case for eliminating the basis step-up at death and taxing inheritances alongside most other income tax proposals, reforming intergenerational transfers faces some significant implementation challenges. While the statutory estate tax rate is today 40 percent, the effective rate is more like 2 percent (Batchelder 2020). A good part of this difference is due to the exemption amount, which is now at an all-time high of $30 million per household. Many of the other gaps, though, are structural flaws in the design of the estate tax system that have allowed for a variety of tax-minimization strategies to flow through. These structural flaws—valuation, liquidity, and bad legal design—would also likely have similar impacts on deemed realization at death or an inheritance tax.

One significant structural weakness of taxes imposed at death is that taxes at death are politically unpopular. Graetz and Shapiro (2011) explore in depth how opponents of the

estate tax worked to build antipathy for "death" taxes. This political liability makes room for loopholes, as it is difficult to gather legislative support to close even the most obvious and abusive tactics for dodging the tax.

For example, advocates recognize that valuation disputes have deeply undermined the US estate tax (Batchelder 2020), and there is nothing inherent in deemed realization at death or an inheritance tax that would mitigate that problem. Taxpayers generally have far more resources available in each individual valuation dispute with the government, and can use those resources to shop for and incentivize appraisers who are willing to give favorable testimony. If anything, inheritance taxes make this problem worse by multiplying the number of times the government would have to litigate the value of similar property.

Taxpayers also control the uses and ownership structure of their property, and can exercise that control in ways that make the property hard to value or low in apparent value. For example, a common tactic is to divide formal ownership of a family business among several relatives, none with a controlling stake. As long as the collective can govern itself amicably, this has little effect on operations, but an unrelated outsider would not likely be willing to pay fair value for a minority stake in a family-controlled business. Targeted reforms aimed at the most popular of these techniques have been proposed repeatedly over the last decades (e.g., in Belcher and Fellows 2004 and Batchelder 2009) without any visible progress. In addition to lowering revenue from the estate tax, these valuation problems also distort wealthy families' investment choices by setting a lower effective rate of tax on assets that are hard to value.

While liquidity may rarely be a real problem for heirs who receive multimillion dollar inheritances, it is at least a key political stumbling block.[50] Graetz and Shapiro (2011) describe how a handful of (mostly apocryphal) stories about forced sales to satisfy estate tax were the center of a decade-long campaign for repeal. In their account, even progressive voters resisted taxes at death, because they believed that family business owners who would otherwise have respected community and sustainability values would be forced to sell to profit-motivated multinationals. In 2017, heirs of Paul Newman pressed similar claims to secure a special exemption from the private foundation rules that would have forced the foundation to divest its ownership of Newman's Own, the food company.

Maybe most problematically, many of the tax planning tools that families now use to minimize the estate tax would work just as well to minimize deemed realization at death or an inheritance tax. A standard form of contemporary wealth planning involves

[50] Some economists also suggest that reallocating asset ownership from heirs, who may have no particular skill in running their inherited business, to willing purchasers could also improve allocative efficiency. A liquidity crunch, that is, might actually be good if it forces this kind of transfer. But, as the main text notes, this is a rationale that is extremely politically unpopular.

transfer of family wealth to a trust during the life of the founding generation. If the grantors (the individuals who fund the trust) have sufficiently divested themselves of formal legal control of the trust, its assets will not be part of their taxable estate.[51] Typically a transfer to the trust results in a gift tax, at effective rates somewhat lower than the estate tax. Skilled planners usually schedule the gift tax to occur at a time when the asset valuation can be minimized; this is sometimes called an estate "freeze" because the estate's tax liability does not rise even if the asset's value increases sharply after the transfer. If the bequest principal remains the property of the estate, with heirs receiving only a stream of payments during their lifetime (a so-called "life estate"), there is no estate tax imposed at the time of the heirs' deaths, either. To fill this gap, the US imposes a GST tax on the trust assets, at the same rates as the estate tax, at the time of the death of certain life estate beneficiaries.

Canada's experience in administering its deemed realization at death regime is instructive.[52] For moderately wealthy households, those with under a quarter-million dollars or so of non-retirement assets, increasing capital gains rates spur greater realization during life (Lavecchia and Tazhitdinova 2024). One plausible explanation for this pattern is that households anticipate that they will face certain tax liability at death, and attempt to shift some liability to lower tax brackets by smoothing out liability over their lifetime. No such quantitative evidence is available for Canada's wealthiest families. What we have instead is the advertising copy of Canadian private wealth planners, who boast on the internet of their ability to eliminate tax liability at death.

We should take advertising with a few grains of salt, obviously, but both the wealth planners and Canadian legal academics consistently describe a series of common tactics for dodging deemed realization. The first step is an estate freeze: The family transfers appreciating assets into a trust. Though Canada does not have gift tax, it does treat gifts as realization events, but again valuation at the time of the freeze is usually on terms very favorable to the taxpayer. Canada is also aware that trusts do not die, and so the deemed realization regime also includes a deemed sale of all trust assets every 21 years. But this brings up the second step of the dance: The trust "rolls out" the appreciated assets to a living heir, usually a minor. As in the US, in-kind distributions

[51] This loophole closes if the grantor retains the right to use the supposedly transferred property during their own life. IRC § 2036.
[52] Canada adopted deemed realization at death in 1982, in the same legislation as reforms ending the total exemption of capital gains. Thus Canada has never had a modern regime like the US in which capital gains are taxed during life but not at death.

from trusts are not generally realization events.[53] So while the freeze is not perpetual, it can delay realization for 20 years, plus the lifespan of the living heir.

US planners can employ freezes and trusts to create perpetual tax-free dynasties. First, the family transfers assets to a trust at a time when valuation can be minimized. Gift taxes can be further reduced by selling assets to the trust rather than donating them, usually in exchange for a pledge of annual payments of cash from the trust in the future (funded through a loan from the grantor or previous, gift tax exempt cash contributions to the trust). The sale does not trigger income tax because the trust is designed to have the particular legal features that make it a "grantor trust," which legally is just an extension of the grantor.

Once the assets are held by a trust, they are often permanently beyond the reach of the transfer tax system. As long as the trust lacks certain key elements of control by the grantor, all the trust assets are treated as no longer held by the grantor, so that they will not be treated as part of the grantor's estate.[54] If assets are distributed to an heir, and not consumed by that heir, then of course the remaining assets could be part of the heir's estate. A common strategy to prevent this outcome is to grant each heir only a "life estate," or right to cash payments during their lifetime, in an amount that the trust administrator determines is sufficient to maintain their lifestyle. The expiration of a life estate does not trigger any estate tax liability; because legally the remaining heirs were already entitled to whatever was left after the life estate ended, they receive no new property rights at its termination.

The GST is supposed to block this tactic, but it is poorly designed. In theory, the GST treats the expiration of the last life estate in each generation as though it were the death of the trust itself, and subjects the trust assets to estate tax. But the GST has an exemption amount, equal to the estate tax exemption. For unclear reasons, the GST exemption is calculated at the time assets are contributed to the trust, not when the tax is triggered. Thus, the GST is itself an estate tax freeze: As long as trust assets are valued at less than the exemption amount at the time of contribution (or the IRS fails to audit the tax return reporting the contribution within the statute of limitations), the trust is perpetually exempt from GST. Galle, Gamage, and Lord (2025) report that upwards of $5 trillion, and quite plausibly more than twice that figure, is now held in trusts that by themselves would be large enough to trigger transfer tax, but that instead

[53] US trusts can elect to treat an in-kind distribution as a realization event. Historically, the rationales for nonrecognition treatment of in-kind distributions were that the distribution did not provide new valuation information or new liquidity, and that any resulting deferral of gain was a second-order matter. In addition, similar to the treatment of tax-free corporate reorganizations, there was a view that tax should not interfere with the "boundary of the firm," the efficient placement of assets inside one entity or another.

[54] For unclear historical reasons, the definition of a grantor trust is different in the income and estate tax systems, so that a trust can be an alter ego of the grantor for income tax purposes but still outside the estate of the grantor for estate tax purposes.

are perpetually exempt because of the GST loophole. That amount is between 3 and 6 percent of all US private wealth.

Example 6.4: Tax Planning for Permanent Estate Tax Exemption

Family Matriarch Dua L. is the founder of a privately-held business DualCo. Dua believes that the next round of venture funding for the business will value her equity stake at more than $1 billion, but this information is not public. Dua causes DualCo to issue a new class of stock ("DualCo Senior"), which does not participate in dividends but will hold 75 percent of shareholder voting power. Any growth in value of DualCo is expected to accrue in the original class of stock ("DualCo Junior"), because that class of stock is entitled to receive distributions of corporate profit. Dua contributes her shares of DualCo Junior to the family trust T, takes the position on her gift tax return that the stock is worth $14.9 million, less than her lifetime GST exemption of $15 million, and thus claims that T is 100 percent exempt from GST. The IRS does not audit Dua's gift tax return within the three-year statute of limitations.

Dua's husband predeceases her. At the time of Dua's death the DualCo Senior stock she owns directly is worth $10 million and the DualCo Junior stock held by T is worth $10 billion. T is not part of Dua's estate and Dua's other assets are worth less than $20 million. Following Dua's death, T distributes $1 billion in DualCo Junior stock to Dua's daughter, DJ. DJ dies tragically shortly thereafter. T also makes periodic payments to Hijo, Dua's son, as part of a life estate for him. Hijo inherits the DualCo Senior stock and so controls DualCo. Hijo eventually dies, leaving his daughter Nieta the sole living beneficiary of the $9 billion in DualCo Junior stock, and sole controller of DualCo.

Results

Dua's estate is below the $15 million exemption and does not owe tax. Neither the distribution to DJ nor DJ's death result in any capital gains taxes on the built-in gains in the DualCo Junior stock.[55] DJ's death incurs estate tax on the $1 billion of stock she owns personally, less her exemption amount, for a liability of 40 percent × $985 million = $394 million. When Hijo dies with no surviving siblings there is a taxable event for the trust under the GST. But the trust is GST-exempt, so the taxable amount is $0. No taxpayer ever makes any tax payments on the $9 billion in DualCo Junior stock.

[55] DJ can exclude the $1 billion in stock from her income because bequests are not taxable. If, however, the trust were to distribute income from the stock, such as dividends paid, those would likely be included in DJ's income. *See* Treas. Reg. § 1.102-1(c), (d).

Even if it were the case that taxes on inheritances should be kept low or at zero, it's difficult to see that as a justification for the modern state of wealth transfer taxes. Many families are able to achieve minimal effective tax rates, but only by means of navigating a complex maze of tax planning under the guidance of expensive legal counsel. Some inherited assets, such as publicly traded stock, are relatively more difficult to plan with. If low rates are the goal, it would be much preferable to institute something like my proposal, but with a low statutory rate, along with lowering the rates of the estate and gift taxes more generally. That way, all families would face similar rates, instead of the current world in which those with a willingness and ability to engage in extensive tax planning get far lower rates than others—a situation that is both unfair and economically distortive.

My argument is not that these implementation problems cannot be solved, but rather that they must be confronted for any meaningful efforts to reform intergenerational transfers, including reforms within the income tax system such as deemed realization at death. Efforts to reform any of those policies must include thoughtful design to ensure that freezes and trusts do not immediately undermine the reform, and that mitigates the inevitable valuation and liquidity challenges to taxing at death.

Many existing proposals address some but not all of these obstacles. For example, the US has twice tried to replace the basis step-up at death with a regime of carryover basis, in which the heir will be liable for built-in gains in inherited assets whenever the heir chooses to sell. That mostly resolves the valuation and liquidity problems. But it fails to solve the problem it is supposed to solve, which is lock-in. Heirs would have an incentive to continue to hold inherited assets, greatly sapping the revenue potential of the reform. Chapter Nine will explore an alternative implementation of carryover basis that mitigates this lock-in problem.

Concluding Thoughts

Reform of inheritances is urgent but difficult. Though the economic arguments for taxing wealth as it passes to another generation are powerful, there is political discomfort with taxes at death, along with an assortment of current legal challenges. The most viable way forward may require changing key elements of that underlying dynamic, such as by shifting the timing of inheritance taxes so that they occur over time or when heirs consume their inherited wealth, rather than at death. Wealth and MtM taxation of investments takes a step in that direction by removing the necessity to treat death as a realization event, and further reforms are possible. In Chapter Nine, I propose a multi-pronged approach in which gifts and bequests are taxed when the recipient sells, with an extra charge for the value of deferral; both heirs and trusts pay an annual excise that is similar to a wealth tax.

Chapter Seven: Retrospective Taxation

• So-called "retrospective" taxes offer a key alternative to annual wealth or MtM taxes. A retrospective tax is imposed at sale, but adds an additional interest-like tax charge to discourage property owners from holding assets in order to defer their tax.

• Depending on the design of the extra interest charge, a retrospective tax can reduce or eliminate the "lock-in" incentive a realization-based system usually creates.

• The most effective retrospective designs give the government a notional equity interest in each asset, so that the government shares in the owner's risks and rewards but has no legal control over private property.

• A fully successful retrospective system also must impose at least some payments before realization.

To this point, I have explored the assorted weaknesses of the way the US today taxes wealthy households. While there is a compelling economic case for taxing the massive investments of the very rich, whether inherited or otherwise, there are several stumbling blocks. The realization principle is the greatest of these. Indeed, realization spills the key lessons of economic theory on their head. When wealth accumulation is itself a source of power and personal satisfaction, we should impose an annual charge for the continuing enjoyment of those privileges. Instead, the realization principle gives wealthy households the choice about when and where to pay tax, and rewards those with the luxury of waiting with a lower rate than those who cannot afford to. A realization-based approach also forces the tax system into difficult choices when a rich taxpayer dies.

And yet, as we have also seen, we may be stuck with some version of the realization principle, at least at the federal level. It is possible the current Supreme Court would conclude that the Constitution essentially rules out many forms of broad-based wealth or MtM taxes.

This chapter pivots from these problems toward possible solutions. If realization is all we have, is there a way to make realization work more like a wealth or MtM tax? The answer is a qualified "yes," though there are some important uncertainties and choices to be made along the way. In general, though, any annual system for taxing appreciated wealth can be converted into a one-time tax imposed later, when the property is sold. The simplest example may be Chicago's property tax "circuit breaker" system, in which

older households can defer their payments until the current resident passes the property to someone else.

This is called a "retrospective" system. In this chapter I'll briefly survey several recent variations on retrospective taxation for the wealthy. In particular, I highlight the differences between two legislative proposals introduced during the Biden administration, the BIT from Sen. Wyden, and the BMIT, which originated as a Green Book outline from the Treasury and was fleshed out in a bill from Rep. Cohen. Other recent analyses of retrospective taxation, notably Hourani and Perret (2025), have failed to recognize the range of available design choices, and especially have neglected the novel features of the BMIT.

Deferral as Debt: The Billionaire Income Tax

The core insight of retrospective taxation is that tax deferral looks a lot like a loan. Suppose that Effie owes $1 million in taxes but doesn't have the cash to pay. She might go to a bank and sign an agreement to instead repay the $1 million five years in the future, while making interest payments in the interim. If we ignore the legal differences and look only at Effie's balance sheet, tax deferral looks quite similar. If Effie gets the benefit of a rule that allows her to pay her $1 million in five years rather than today, that is no different than her borrowing $1 million—in this case from the government—to pay her off liability today. The difference is that, in most cases, the government will not charge her interest. As we've seen, that is precisely what makes the realization principle so valuable to wealthy investors: It lets them postpone paying tax on investment gains without being charged any interest for that privilege.

Thus, in a retrospective tax system, taxpayers who get the benefit of waiting until sale must pay interest on the time value of the deferral (Vickrey 1947). This is part of the approach of the BIT bill proposed by Sen. Wyden. For the most part, the BIT was an MtM tax imposed on certain very wealthy individuals (those with more than $100 million in income or a three-year average of $1 billion in assets). For "non-traded" assets that were not available on a stock exchange or similar marketplace, however, the BIT applied the standard realization rule, imposing tax only at sale. But upon sale, there was an extra amount of taxable gain, which was supposed to represent an interest payment on the deferred tax liability that would have been imposed if the asset had been subject to MtM treatment. The BIT assumed that an asset had grown in value an equal amount each year and then charged interest as though the taxpayer borrowed from the government in an amount equal to the tax that would have been owed on that increase in value (Wyden 2021). The interest rate that applied was essentially the interest rate payable on the federal government's own debt, which typically is among the lowest rates in the world. Taxpayers who weren't allowed to defer assessment of their tax bill were still allowed to defer payment, with modest interest charges over an eight-year period.

Example 7.1

Richard Founder owned Spacebook stock, which grew from $100x to $1100x between years one and 11 when it was sold. A BIT was in place at a 20 percent rate.

Results

The BIT assumed Spacebook increased by $100x in each year between year one and 11 ($1000x in total appreciation / 10 years of ownership = $100x growth per year). At a 20 percent tax rate, that $100x increase would have caused a $20x tax bill. Upon sale in year 11, Rich would owe tax on all $1000x in gain. The BIT would then charge nine years' worth of interest on the $20x year two tax bill, eight years' worth of interest on the $20x year three tax bill, and so on.

The point of the BIT's interest charge was to keep taxpayers from fleeing from traded to non-traded assets. Absent the interest charge, non-traded assets would have been much more desirable, because they would have preserved the option to take out an interest-free loan from the government. Thus the drafters hoped that, with the interest charge, the effective tax burden on both kinds of assets would be similar.

The interest charge would ideally also reduce the lock-in problem. Taxpayers who held or switched to non-traded assets would be locked in by the realization principle, because the longer they held the asset, the lower the effective tax rate. The interest charge pushes in the other direction, making holding an asset more expensive the longer it is held.

Treating deferred tax liabilities as debt has some important limitations, though. One is that once the government is a creditor, it faces the problems all creditors face, such as the possibility that the borrower (here the taxpayer) might be bankrupt or illiquid when the bill comes due (Knoll 1996). A simple interest charge also does not eliminate a taxpayer's financial incentive to defer realization of gains, and likely would also preserve the incentive to accelerate realization of losses (Gergen 1993; Glogower 2018). Consider again the BIT. If Rich believes that he can earn a better return on his investments than the interest rate charged by the statute, he would still prefer to delay paying tax. In effect, he would be borrowing from the government at the statutory rate (on average at a recent historical rate of about 2.9 percent) in order to invest in his business, which he expects to average, say, a 10 percent return. Similarly, if Rich believes that most of the gain in value of his stock will occur in years one and two, he will believe that he is getting a bigger bargain the longer he holds the stock. By assuming equal gains each year, the statutory formula shifts interest from early years,

when the gain in value really occurred, to later years of Rich's holding period. The longer the holding period, the larger the shift.

Auerbach and Bradford (2004) solved this latter problem but still left taxpayers with strong incentives to defer gain. Their "dynamically adjusting" model improves over a simple interest charge with a complex formula that avoids the simplifying assumption that assets gained equal value every year. They prove mathematically that their method should leave taxpayers perfectly indifferent to the timing of realization so long as it is the case that income taxes do not burden the "risky return" on assets. The intuition behind their result is simple. The government imposes a tax that, at every point in time, looks to the taxpayer as though it will require an interest payment exactly equal to what the taxpayer could earn in a risk-free investment. Taxpayers with risky investments do not care about delaying taxation because, by assumption, the income tax does not impose any net cost on such investments. So the risk-free rate is sufficient to keep investors indifferent between selling and holding their assets.

In fact, though, taxpayers with risky bets care a great deal about avoiding tax on those wagers. Briefly, in an ideal system, taxes do not affect risk because a taxpayer can always scale up their bets: If there is a 50 percent tax, the taxpayer bets twice as much. Transaction costs and tax rules spoil this strategy, however (Bankman and Griffith 1991; Weisbach 2004). It is costly to raise money for risky bets—among other reasons, because funders cannot readily observe the value of the bet and may not trust the risk-taking entrepreneur to protect the funders' interests. These are known as the "asymmetric information" and "agency cost" problems. And doubling one's bet is a bad plan if it turns out that losses are not fully deductible, as they are not in most income tax systems. Thus, even the Auerbach and Bradford (2004) method fails to achieve neutrality, as in actuality the income tax indeed burdens risky returns.[56] Under their method, investors can still borrow from the government at low rates and earn higher returns.

Auerbach and Bradford (2004) also fail to account for rents. Recall that today many wealthy investors are wealthy because they have access to monopoly-like profits, such as from pharmaceutical patents or vast networks of users. These returns are rare in the economy overall but much more common among the wealthiest investors, whose average returns are much higher than other households (Balkir et al. 2025). Once more, investors with access to these kinds of opportunities will be eager to borrow from the government at 3 percent to earn a 10 percent payoff. As I discussed earlier, economic models often assume that this kind of scaling up is impossible for rents: If an investor has access to such a good investment, why wouldn't they have maximized it already? One answer is that, again, scaling up investments is not free or easy, even if they have great payoffs, because of flaws in the market for capital, such as asymmetric

[56] Retrospective systems also may not always solve the liquidity problem because the value realized at sale may not be sufficient to cover the interest charge.

information and agency costs. Several government programs have aimed to address exactly this funding problem for life-saving drugs in early development. As another measure of whether these two problems are socially important, consider that they serve as the economic rationale for the existence of the SEC, which has an annual budget of about $2 billion.

It could be argued that, even if it's the best we can do, a low rate at around the rate on federal bonds is best because it avoids the risk of overcharging some taxpayers (Glogower 2018). That might be the most politically viable approach (assuming we were constrained only to use debt-like retrospective models), but economically it is often defensible to impose a rate higher than the risk-free one. For the most part, the cost of any errors in setting the correct interest rate are likely to be symmetrical, which is to say it's just as bad to set rates too low as too high. If the interest charge is too low, taxpayers will hold assets longer than they should; if it's too high, they will sell them faster than they should. Both can result in misallocation of capital, and it is not obvious that selling too soon is any more damaging to the economy than selling too late.

It is usually preferable instead to minimize the magnitude of the government's errors. Because the economic damage from mispricing rises exponentially with the size of the distortion, it's typically better to have several small mistakes than one big one, even if the small errors total up to more than the big error in aggregate (Kaplow and Shavell 1996). To implement that principle, the government should probably aim to choose a value near the middle of the distribution of investors' rates of return, rather than selecting one at the extreme lower end.[57] Admittedly, overtaxing may be a greater concern for individuals with relatively little wealth, for whom there is steeply diminishing marginal utility. But there are few, if any, large investors with hard-to-value assets in that population.

In any event, whatever the optimal interest rate to charge, it is evident that these methods all involve trade-offs. Setting one interest rate for all taxpayers will necessarily still leave many of them sensitive to the timing of when they sell. The alternative, perhaps, would be to try to measure for each taxpayer the rate of return they expect to earn on their next available investment dollars. That would be the number they have in mind when they decide whether to delay a realization event or not. But how can we know what's in the taxpayer's mind?

[57] For example, suppose that Al, Betty, and Chaz expect to earn profits of 1 percent, 5 percent, and 10 percent, respectively. If the government sets an interest rate of 1 percent, it will only be off for two taxpayers, but the total error will be (1 − 1) + (5 − 1) + (10 − 1) = 13. If it sets a rate of 5.5 percent instead, it will be off for all three taxpayers. But the total error will be only (5.5 − 1) + (5.5 − 5) + (10 − 5) = 10. More importantly, since economic cost is an exponential function of the error size, the *squared* error in the first case is 169, and in the second only 100.

Deferral as (Notional) Equity: The BMIT

Although mind readers are not likely to be available for tax administration, a retrospective tax doesn't need telepathy to measure the rate of return a taxpayer could earn from a given investment, because at the time of sale that rate of return is directly measurable. That was the insight of authors such as Kaplow (1994) and Land (1996). Once we calculate the internal rate of return the taxpayer has available from an asset, we can charge the taxpayer interest at that rate upon sale. If taxpayers know in advance that will be their tax bill, they should have no reason to delay sale: Any funds saved by deferral will earn the taxpayer's available rate of return, but that is also the additional amount of tax that deferral incurs. Or, equivalently, we can calculate the tax payment that would reduce the taxpayer's overall return from a pre-tax rate of return to an after-tax rate of return. Again, if taxpayers know that will be the expected tax bill, it doesn't matter when in time they choose to sell, because the result will always just be the after-tax return.

Example 7.2: Retrospective Taxation with After-Tax Returns

Richard Founder owned Spacebook stock, which grew from $100x to $200x. A Land (1996)-type retrospective tax is in place at 20 percent rate.

Results

The pre-tax return on Spacebook is 100 percent. With a 20 percent MtM tax and with continuous compounding, that pre-tax yield would have yielded an after-tax increase in value from $100x to $174x. Therefore the tax payment that is due is $200x - $174x = $26x. This represents $20 of tax and $6 for the time value of deferral.

The BMIT adopted a variation on this scheme. For the most part, affected households would have paid the higher of their regular tax bill or an amount that was calculated by marking-to-market their assets. Only very wealthy households would have been affected, as MtM liability phased in starting at $100 million in net assets. Families with certain highly illiquid or hard-to-value assets were allowed to elect to open an "unliquidated tax reserve account," or ULTRA. An ULTRA allowed the household to defer payment until sale of the elected assets. In exchange, however, the household gave the government a 20 percent interest in the sale proceeds of the asset, and also had to make certain smaller interim payments which I'll describe more below.

As Galle, Gamage, and Shanske (2023) explain, an ULTRA is essentially a notional equity interest in a taxpayer's assets, held by the government. That is, the taxing authority has

a claim upon a specified percentage of the value of the assets to which an ULTRA is attached. When those assets are sold or otherwise disposed of, the taxpayer must pay the government its share out of the proceeds. Like other notional interests, such as swaps and derivatives, an ULTRA grants no formal ownership or governance rights. Thus, for example, the tax authority cannot vote for directors of a corporation subject to an ULTRA nor invoke corporate law doctrines protecting minority shareholders.

Because it may be hard to understand an ULTRA's operation in the abstract, let us consider the example of how an ULTRA could work within the context of an annual 1 percent tax on wealth. Suppose Shari Shareholder owns $90 million worth of stock in a privately held business. In the first year of the wealth tax, she is subject to a 1 percent tax, or $900,000. However, instead of paying the tax immediately, she grants the government an ULTRA representing a 1 percent notional interest in the attached stock assets. If the stock ultimately sells two years later for $100 million, Shari will still owe the government 1 percent, which then would mean a $1 million payment. If the stock instead later sells for only $80 million, she would owe the government only $800,000. In effect, Shari's $900,000 tax bill will grow at exactly the rate of return earned by the assets to which an ULTRA is attached, even if that rate is negative. It is in this sense that we can say that an ULTRA represents a notional equity interest.

Notice also that an ULTRA yields the same results as the Land (1996) method, and in this case without any need for additional computation of the pre- and after-tax yields. Algebraically, the taxpayer's share of sale proceeds will always be the after-tax yield: the pre-tax value of the asset, less the government's percentage share. As with Land (1996), then, an ULTRA should make taxpayers indifferent about when to sell. Suppose Shari saves money today by deferring tax on her stock holdings, and reinvests those funds in the stock (or, equivalently, suppose that she would have paid the tax by selling some stock). Her profit from that delay will be the amount of tax saved times her rate of return. But this is exactly the extra tax charge the ULTRA will impose at sale. The ULTRA is therefore the equivalent of an interest charge at the internal rate of return of the taxed asset.

In the case of a recurring tax like an annually-assessed wealth tax, the government's ULTRA interest would be adjusted on an ongoing basis to account for the recurring tax assessments. For instance, if Shari holds her stock into year two, there is now another 1 percent wealth tax assessment, paid with an addition to the notional equity interest owed to the government. With a small bit of math, we can calculate the government's overall share that represents the two years' worth of tax assessments. Specifically, the notional equity interest owed to the government would increase by applying the 1

percent tax rate for year two to the 99 percent of the notional equity interest retained by the taxpayer, for a total of 1.99 percent.[58]

To continue the example, let's say that Shari continues holding her shares with an ULTRA attached until she sells all of the shares for $100 million of cash at the beginning of year five. The government would then be entitled to 3.9404 percent of the value of that cash sale—$3,940,400—reflecting the government's notional equity interest in the shares at that time.[59]

The BMIT deferral system worked a bit differently than in this wealth tax example, because of course an MtM tax burdens only previously untaxed gains, not the full value of an asset as in a wealth tax. We want taxpayers who expect to outperform the economy's average return to expect that they will be charged interest at exactly the rate they earn. Thus, unlike with a wealth tax reform, we cannot simply apply the percentage we calculated for the government's notional equity interest. At sale, therefore, the BMIT would have applied the Land (1996) calculation for each asset, in which the taxpayer computes the actual tax payment that would reduce the asset's payoff from its pre-tax return to an after-tax rate of return. This after-tax return is what the taxpayer would have retained under annual MtM taxation. The computation follows a simple formula that can be programmed into a spreadsheet program or calculator app.

Although ULTRAs do require some compliance burdens, these burdens are similar to what the existing income tax requires for tracking basis and adjusted basis. For most financial assets, taxpayers' brokers could potentially track and report the government's notional equity interest, just as they now track basis.[60] Simplifying rules, such as those used now to ease the burden of tracking basis for individual shares held through mutual funds, could also be applied to an ULTRA.[61]

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[58] That is, the notional equity interest owed to the government would increase by 1 percent × (100 percent − 1 percent) = 0.99 percent, so that the taxpayer would enter year three with a total notional equity interest owed to the government of 1.99 percent.

[59] Continuing the example, the notional equity interest would be increased by another 1 percent × (100 percent − 1.99 percent) = 0.9801 percent in year three, bringing the total notional equity interest owed to the government to 2.9701 percent at the end of year three. Then in year four, the notional equity interest owed to the government would be increased by another 1 percent × (100 percent − 2.9701 percent) = 0.9703 percent, bringing the total notional equity interest owed to the government to 3.9404 percent at the end of year four.

[60] *See* T.D. 9504, 2010-47 I.R.B. 670 (announcing new regulations requiring brokers and select other institutions to track customer basis).

[61] Treas. Reg. § 1.1012-1(e)(1).

Payments Before Sale

Although the BMIT allowed optional deferral in some cases, even taxpayers who made the deferral election still made some payments in advance of sale. While some of these payments were optional, others were mandatory. All of them were ultimately credited against any tax due at the time of sale.

Any retrospective system likely needs at least some mechanism for addressing efforts to "strip" or remove value from an asset. Imagine that Shari's company is worth $100 million, with a $1 million basis, but she causes it to borrow $99 million and pay her a dividend in that amount. She then sells the stock for $1 million, resulting in no taxable gain and, crucially, no retrospective interest charges. Advocates of retrospective reforms have generally disfavored Land's proposal because they suggest it cannot handle these kinds of partial withdrawals, nor interim contributions or deemed withdrawals, without creating excessive complexity and administrative and compliance burdens (Schenk 1997; Glogower 2018).

Integrating Land's proposal with the ULTRA method solves these issues. Whenever a taxpayer takes a withdrawal from an asset subject to an ULTRA, the BMIT requires them to pay a withholding tax in the amount of the government's share times the amount of the withdrawal, as if they had made a partial sale of the asset.[62] The payment was a "withholding" tax in the sense that it was credited against tax on any later sale, and so in a sense was just a down payment against that subsequent liability. Using the ULTRA method as a withholding mechanism integrated with using Land's approach for calculating the final tax assessment thus offers the valuation accuracy of Land's proposal while mostly solving the administrative and compliance problems that would arguably be created by using Land's proposal without the ULTRA method.

Some academic proposals go even further in requiring partial payments in advance of retrospective resolution of full tax liability. Galle, Gamage, and Shanske (2023) suggested that taxpayers who elect retrospective treatment should have to make annual down payments against their ultimate payment, such as a payment equal to the amount by which the government interest in the taxpayer's assets had increased that year. Kleinbard (2016) proposed a more elaborate system in which businesses are taxed only on super-normal returns, while individual investors make an annual payment of

[62] Computing the government share requires an additional step for an MtM tax. We can rely on the well-known observation that when all assets earn the same rate of return r, a wealth tax with rate t_w is economically equivalent to an income tax with rate t_w / r. Thus, from an ex ante perspective, any wealth tax method can be translated into an income tax method simply by assuming a presumptive rate of return for all assets, such as 5 percent. Algebraically, this equivalence ($t_i = t_w / r$) implies that the government's notional equity interest accumulated each year should be the applicable income tax rate multiplied by the presumptive rate of return ($t_i \times r$). In the BMIT, the IRS annually determined this average rate of return.

the deemed normal return on capital. Taxpayers would then calculate their actual return at sale and would receive refunds if the sum of their deemed returns exceeds their real payoff. Both proposals were aimed at accelerating a portion of the retrospective payment to improve the 10-year revenue score and reduce the extent to which households might believe that they could escape ultimate tax liability through later legal changes. I discuss these considerations more in the next chapter.

BMIT taxpayers could also opt in any year to accelerate their deferred tax liability, even if there were no realization event in that year. The concern with this optional resolution, as in the case of taxes at death, is that valuation at a time other than sale tends to heavily favor taxpayers. Valuations provided by taxpayers or by expert appraisers hired by taxpayers are inevitably highly gameable. Formulaic valuations can work well enough for some assets, but it is impossible to design formulas capable of valuing all important forms of assets. If valuations are instead provided by the tax authority or by third-party experts hired by the tax authority, then due process concerns necessitate offering taxpayers a way to either reject or challenge the valuations. But offering taxpayers a way to challenge these valuations then recreates many of the problems with taxpayer-provided valuations because sophisticated taxpayers will often bring much greater resources to litigation or other valuation-dispute proceedings as compared to the resources available to the tax authority.

Offering ULTRAs as a voluntary option presents a way out of this dilemma. Specifically, the ULTRA option was an alternative to a regime where appraisals were all controlled by the tax authority. In this combined "take-it-or-leave-it" alternative valuation regime, the IRS could hire third-party expert appraisers to value taxpayers' assets and taxpayers would not generally be permitted to challenge these valuations.[63] But taxpayers would have still had recourse to reject these valuations in favor of another alternative valuation: the value they would realize after accepting an ULTRA and later selling the asset. In place of using challenge or dispute mechanisms, then, due process was protected by granting taxpayers the option of rejecting the government's valuations and instead attaching an ULTRA to their assets.

[63] For an analogous existing regime, consider the small tax case procedures of Section 7463 of the IRC, whereby eligible taxpayers can elect into a process that results in summary opinions that cannot be appealed and that may not serve as legal precedent.

To elaborate just a bit more on some specifics, the taxpayer should perhaps be provided with a very limited ability to contest these valuations through an internal review process managed by the tax authority (without having to reject the valuation in favor of an ULTRA). But this internal review process should be limited to the taxpayer showing clear mistakes in the valuation (an example of what might constitute a clear mistake is if the wrong assets were appraised). Importantly, the taxpayer should not be permitted to provide their own expert appraisal valuations as part of this review process. Then, any subsequent judicial review should be limited to a showing of abuse of discretion by the tax authority.

This approach presents taxpayers with something of a gamble in deciding between the take-it-or-leave-it alternative valuation option and the ULTRA option. This is because the notional equity interest granted to the government by an ULTRA will result in larger tax obligations the more and the faster the asset grows over time, whereas the take-it-or-leave-it alternative valuation option would be based on assessing the value of the asset at the time of the valuation. Because the future is uncertain, it will typically be impossible to predict with certainty which option will result in overall lower tax obligations.

The theory of the ULTRA, therefore, was that deferral would be attractive only to households that genuinely had serious liquidity constraints (Galle, Gamage, and Shanske 2023). To the extent taxpayers lack such concerns, they should often be better off selecting the alternative take-it-or-leave-it valuation option so as to avoid the restrictions of keeping the assets in an ULTRA and thereby offering the government a notional equity interest in those assets. The tax planning implications of this choice will not typically be clear-cut, as they will depend on the uncertain future growth path of the assets. Thus, taxpayers in this situation should find that they face incentives to reveal whether they have genuine valuation or liquidity or similar concerns by only opting for ULTRAs when they have such concerns and otherwise opting for the alternative take-it-or-leave-it valuation regime.

The taxpayer option approach solves the problem of inherited assets, which represent another serious flaw in prior retrospective proposals. Before the BMIT, proposals for retrospective reforms generally required that the taxpayer's death (and, often, gifts during life) trigger tax realization because otherwise these reforms would fail (Glogower 2018). Yet taxpayers generally know that the valuation they will face at death will be much lower than the asset's true price. The Due Process Clause limits government efforts to impose its own appraisal rules. So without a robust alternative valuation methodology, taxpayers could face strong incentives to avoid cash sales or cash distributions during life in the hopes of playing valuation games upon death or upon other allowed noncash distribution events.

The BMIT instead rolled liabilities over to heirs, but heirs always had the option to prepay their liability at any time, subject to a more level valuation playing field. That is, if an heir received property that had been subject to an ULTRA, the heir could either continue to maintain the inherited shares with an ULTRA attached (effectively also then inheriting the notional equity interest owed to the government for those shares) or else triggering the alternative take-it-or-leave-it valuation regime (and thereby accepting the valuation assessment so determined). Because the heirs had the option of maintaining the inherited shares within an ULTRA rather than accepting the alternative take-it-or-leave-it valuation option, due process would be satisfied. Further, most households subject to the BMIT would have strong incentives to voluntarily settle any

ULTRA accounts before the death of the initial holder, because that would avoid the possibility of also paying estate tax on funds needed to pay off the income tax bill.

Concluding Thoughts

Retrospective taxes solve many of the dilemmas of taxing the rich. Though they operate primarily at the time of realization, they have the potential to yield the same revenue as if the government were able to impose a full MtM tax, and to unshackle markets from the lock-in problem. Real-world implementations of retrospective taxes have taken only tentative steps in this direction so far, however. Even the most fully developed proposals, such as Kleinbard (2016) and the BMIT, relied mostly on annual taxes, with small exceptions for deferral or readjustment at the time of sale. Are there any reasons to go farther, or is it enough to reserve retrospective methods for the small subset of hardest-to-value or illiquid assets? The next chapter considers that question.

Chapter Eight: A FAST Retrospective System

• The FAST is a retrospective, realization-based tax in which tax deferral does not give property owners any economic benefit; owners pay tax at sale and face an extra interest charge at their property's internal rate of return when sale is deferred.

• Because it is imposed only at sale, the FAST is fully consistent with any constitutional restriction on taxation of unrealized gains, and this may be a reason to prefer it to other proposals.

• For budget and political-economy reasons, taxpayers can choose to prepay their FAST liability, subject to government-favorable rules for valuing assets.

• Certain tax-avoiding transactions, such as dividend payments to related parties, are treated as partial sales and also trigger tax.

• Even if the Constitution prohibits tax on unrealized gains, voluntary payments and narrow taxes designed as anti-abuse rules are both likely permissible.

An implication of the analysis in Chapter Seven is that there is a spectrum of retrospective taxation, ranging from systems that compute and collect all taxes annually (or even more frequently, in the case of quarterly withholding) to those that allow taxpayers to choose to defer when tax is measured and paid. A simple wealth or MtM tax falls into the first category. Other existing taxes take small steps toward deferral, as in the case of the MRT that was at the heart of the *Moore* case, under which some owners of non-US businesses were taxed immediately on foreign profits, but had eight years to pay the bill. Again, the Wyden BIT bill included even more deferral elements, in that it allowed individuals who owned non-traded assets to delay both the date tax was measured and also the date of payment. The BMIT bill fell somewhat in between the MRT and the BIT: Although it allowed optional deferral for some taxpayers, it also imposed mandatory (but potentially refundable) prepayments against any deferred liability.

The FAST proposal described in Chapter One can be seen as one more step past the BIT toward a fully retrospective system. The idea of the FAST is that all taxpayers wait until an actual realization event before they must assess and pay tax on their investment gains. Like the BMIT, the FAST adjusts the tax rate that applies at realization so that there is no time-value advantage for taxpayers in waiting. And the FAST allows households to choose to pay on an annual basis, in exchange for a lower tax rate. For taxpayers who do not choose annual taxation, certain potentially tax-avoiding or

abusive transactions also would trigger required prepayments against the household's potential deferred liabilities.

Why bother with the FAST if the BMIT already resolves the fundamental valuation and liquidity challenges of taxing capital income? Each of the different stops along the path from fully annual taxation to fully retrospective offers a set of trade-offs. That means, of course, that each has something to offer that the others lack. I co-authored the BMIT legislative text, and would be happy to see it become law. But it is likely that the constitutional constraints Congress must work within are now tighter than when the BMIT was drafted.

Why FAST?

To see the potential appeal of a FAST, let's start by considering the pros and cons of a purely retrospective tax system. Ultimately the FAST is not purely retrospective, but in ways that likely keep the benefits of the pure retrospective approach.

The key advantage of a retrospective tax is that it is clearly constitutional. The Supreme Court signaled in the *Moore* case that it was open to the argument that the term "income" in the 16th Amendment does not encompass unrealized gains on property prior to sale (or other disposition). By definition, a retrospective tax is only imposed at sale. The only thing that distinguishes it from plain old capital gains is the tax *rate*, which gets higher the more or the longer the asset has appreciated in the taxpayer's hands. There is no constitutional principle that limits how Congress sets tax rates, as long as the same rate schedule applies uniformly to everyone. The US has imposed different rates on investment properties that were held for different amounts of time since the invention of the concept of "long-term" capital gains in 1921.

A retrospective tax may also strike some voters as more intuitive than an MtM tax, even one with optional deferral. Some survey evidence finds that respondents resist asset taxes that would be imposed prior to sale, even when the tax is limited to households so rich that liquidity is unlikely to be a serious concern. Critics of the BMIT generally ignored the optional deferral sections, focusing instead on the supposed valuation and liquidity problems of a standard MtM tax. That leaves defenders of BMIT-type approaches in the position of having to explain the sometimes-complex workings of their deferral rules. Graetz and Shapiro (2011), in their analysis of the estate-tax debate in the early 2000s, found that optional deferral provisions had little or no impact on voters' liquidity concerns, largely because those provisions were much less salient than the tax itself, and were difficult to explain.

A retrospective tax with a FAST-type interest charge also fits well with the economic rationale for taxing the ultrarich differently in the first place. As Kleinbard (2016) argues, taxes on investments should be "progressive in time": Households with the

luxury to hold their property for decades are revealing their greater ability to pay and therefore should pay higher rates. Households that own vast wealth and can use it to enjoy power, prestige, and influence are thereby bringing in imputed income that the regular income tax system misses. By imposing a tax burden that rises over time, the FAST in effect taxes that imputed income from wealth, just as an ideal income or cash flow consumption tax would. And by imposing a deferral charge at the taxpayer's own rate of return, instead of a lower amount such as the risk-free rate proposed in Auerbach and Bradford (2004), the FAST captures the super-normal returns that are common for the wealthiest investors.

The rate structure of a retrospective tax might be a bit unfamiliar to some voters, but it is hardly unique. Again, a FAST-type retrospective tax will impose higher rates on the sale of assets that have appreciated more: The better your investment performs, the higher the rate. That's a bit different than the standard progressive income tax, which figures rates based on all of a person's income in a given year, rather than asset-by-asset. Yet within our familiar system, we do have some assets whose tax rates vary with their own performance, not the income of the owners. So-called C Corporations, the ones that pay the corporate income tax, are the most obvious example.[64]

We might also worry that a retrospective tax would struggle to raise substantial revenue over a 10-year budget window, but in fact it could readily raise hundreds of billions or trillions of dollars, depending on exemption amounts.[65] Under current law, taxpayers are reluctant to sell appreciated assets due to the lock-in effect. Properly implemented, a retrospective tax should eliminate lock-in, as taxpayers would face an interest charge that equals any of their gains from deferral. So although the retrospective tax is not imposed until sale, sales happen much faster. To be sure, it will still likely not score as well as a pure MtM tax.[66] Under a pure MtM approach, all the

[64] Other examples include US withholding tax on certain dividend and interest payments to non-US investors.

[65] The Green Book revenue estimate for the BMIT was about $500 billion over five years. Wealth of the US top 1 percent has risen about 11 percent since that estimate (FRED: Total Assets Held by the Top 1 Percent), so that would be about $555 billion today. My proposed threshold for the FAST is much lower than the BMIT, probably reaching households with about $30 million in gross assets, while the BMIT began at $100 million in assets net of liabilities. Leiserson (2020) estimated a 10 year revenue score for an MtM tax of about $3 trillion, with a threshold of new wealth of about $16.5 million in 2020 dollars, probably around the same group of households that the FAST would reach.

[66] The Green Book estimate of $500 billion for the BMIT was drafted before legislative language in the Cohen bill that added optional deferral for illiquid assets and an improved mechanism for resolving valuation at death. The net effect of these changes on revenue is uncertain. Optional deferral likely delays some revenues, but the enhanced valuation methods it allows raise revenue. Without these valuation mechanisms in place for taxation at death, there would likely still have been substantial lock-in under the original Green Book proposal. Thus it is possible that the Cohen bill version of the BMIT would have had a higher revenue score. Similarly, it is plausible that the FAST would raise more than $555 billion because of its reduced lock-in effects.

economic gains (and losses) that occur within the 10-year budget window would be taxed within that period. A retrospective tax would miss economic gains that occur within the window but are not realized until outside the window (though this would be a revenue advantage in the case of unrealized losses). On the other hand, depending on transition rules, the retrospective tax could do better at capturing gains that occurred *before* enactment—for example, if the MtM system exempted preexisting gains, as the BIT effectively did.

A purely retrospective tax would thus likely have two advantages over hybrid approaches such as the BMIT, with similar revenue potential, but it would have some distinctive vulnerabilities as well, especially those related to the tax holiday or "political optionality" problem (Kleinbard 2016; Hemel 2019; Brooks and Gamage 2023). Rich households facing large deferred retrospective tax bills would have incentives to lobby for repeal before those bills come due. We could call this the problem from Mars: As Graetz and Shapiro (2011) describe, the Mars family (of M&M's fame) was a key mover in efforts to repeal the estate tax before they would have to pay it. Obviously, if these kinds of efforts succeed then deferral regimes will not actually bring in their projected revenues.

The possibility of repeal can affect the official revenue potential and economic efficiency of a retrospective tax in other significant ways, as well. The retrospective tax defeats lock-in by promising households that they will face the same effective tax burden whether they sell today or in a decade. If, however, the household believes that the interest charge will be repealed before sale, they will again have incentives to hold their assets at least until after repeal. That will distort investment decisions and push some realizations back outside the budget window, even if the taxpayers never actually succeed in their repeal efforts.

Deferral also makes the government effectively a creditor of each investor who holds appreciated assets. Retrospective taxation does help with the classic liquidity problem, in the sense that presumably a taxpayer who sells their property has sale proceeds available to pay the tax bill. But that need not always be the case. Sometimes the "sale" is actually a foreclosure, forcing the government to compete with other creditors for a slice of the pie. Retrospective taxation could even worsen this problem. Suppose a taxpayer, Deb Tor, knows that she will face a large future retrospective tax bill of $10 million on her investment, worth $20 million. She might pledge the asset as security, take out a $20 million loan, and spend the proceeds on caviar and champagne. When the debt comes due, so does Deb's tax, but she has already spent the sale proceeds: Between the government and the bank, there is still only $20 million to claim.

Put another way, a purely retrospective tax is constitutionally sound but less than ideal politically and economically. That fact could be the basis for a critique of the Supreme Court's realization revival. There is no textual basis for a realization rule in the 16th

Amendment; at best, the meaning of "income" in the early 20th century was contested and varied from context to context. Where the text leaves room for policy judgment, constitutional rules should serve, rather than undermine, social goals. The Constitution shouldn't force us to adopt a worse tax system. Policymakers outside the Supreme Court, however, must make due with the law we have, and for the near future it seems likely that law may well require realization at least in some cases.

The FAST and Voluntary Annual Payments

The FAST aims to hit a sweet spot in which it shares most of the constitutional features of a pure retrospective tax while mitigating some of the policy downsides. Once more, it departs from the pure retrospective method in two respects. Households can voluntarily agree to make annual payments rather than facing one retrospective bill. They can do that at any time by treating the electing year as if their assets had been sold, and then making annual payments in the years following, so that no further interest accumulates. Certain tax-avoiding transactions would trigger a partial down payment against future liability.

Allowing taxpayers to opt out of retrospective taxation serves a few key goals. Most obviously, for revenue scoring purposes, it moves some of the revenue that would be realized outside the 10-year budget window into the window (but also may shift forward some of the losses).[67] Voluntary payments additionally mitigate the government's credit risk, as by the time a taxpayer sells or loses their asset to foreclosure most of the tax bill on that asset will already have been collected.

Prepayments can also reduce the political optionality problem, but just how much they do so likely depends on how relatively attractive a deal the government offers. Suppose we have a taxpayer, Sy Kick, who foresees that existing retrospective tax rates will be repealed before he opts to sell his highly appreciated family karate business, Kick Karate. Why would Sy choose to pay on an annual MtM basis when he expects that he could instead delay paying and face no extra interest charge for the time value of money? If he were certain of repeal, perhaps he would never opt to pay in advance of sale. But more realistically, Sy's crystal ball is sometimes cloudy. Then he would compare the gains from waiting, discounted by the possibility they will never arrive, against the advantages of opting into annual payments. If the benefits of annual payments are appealing enough, he might take the deal.

What, then, are the possible benefits to a household for opting into annual payments? The decision to opt in is similar to the decision many taxpayers today face when given the chance to convert their traditional IRA to a Roth account. Withdrawals from

[67] Taxpayers who expect early losses and later gains may be especially attracted to voluntary payments because they might be able to claim deductions in early years. The FAST mitigates this cherry-picking problem by requiring taxpayers to elect prepayment for all assets, not one asset at a time.

traditional IRAs are taxable, while Roths are tax-exempt, but to convert the account owner must pay tax on the existing IRA gains. Similarly, the FAST opt-in allows a household to eliminate interest-like tax charges by paying up front instead. Financial planners generally support Roth conversions because they effectively allow the account holder to buy pre-tax returns with after-tax money (Scholes et al. 2015).[68] The FAST conversion can provide similar benefits, especially for households that have (or believe that they have) access to super-normal returns.

To see this, suppose that Sy holds stock of Kick Karate in which he expects to earn a return of 20 percent, but he can borrow at a lower fixed rate of interest of 10 percent. If Sy pays tax on Kick profits now, he will have to borrow, say, $1 million at 10 percent annual interest, to be paid off when he sells the shares.[69] But if Sy instead chooses to pay tax on Kick profits when he later sells the shares, the FAST will adjust his tax rate at sale so that he effectively pays a 20 percent rate of interest on that $1 million tax, because that is the internal rate of return on the asset. So borrowing to prepay is the right call, because obviously Sy will happily pay 10 percent of $1 million to save 20 percent of $1 million.[70]

Example 8.1: Making the Prepayment Election

Sy owns Kick Karate, which has a basis of $1 million and a fair market value of $2 million. Kick earns a 20 percent (compound) average annual profit. Small business bank loans are available to Sy at a 10 percent interest rate. The FAST is in effect

[68] Imagine that to pay for the tax on conversion the taxpayer must borrow, and interest rates and investment returns in the economy are all 6 percent on average. Suppose the taxpayer uses cash from outside the IRA to pay their tax bill. Assuming a 33 percent rate of tax, the after-tax return on this cash is 4 percent; this is the amount that the taxpayer gives up when using the cash to pay for the conversion. But the funds inside the account now earn a full pre-tax return of 6 percent. Alternatively, the taxpayer might borrow to pay the tax bill. Though interest on personal debts is usually not deductible, most high earners can easily rearrange their funds so that any new debt is tied to a business or investment use. The account holder can thus borrow at an after-tax rate of 4 percent, but earn a pre-tax return of 6 percent, which is still 6 percent after tax when inside the Roth.

[69] Equivalently, we could stipulate that Sy owns both the rent-producing asset with a 20 percent expected return and a normal asset with a 10 percent expected return, and that he can choose to sell the normal asset to pay the tax.

[70] Readers may wonder why, if Sy can pay off his tax liability with a loan at 10 percent, it is appropriate for the FAST to charge interest at each asset's internal rate of return, rather than the applicable borrowing rate. The answer is that FAST is presuming that at the margin the taxpayer has the ability to make additional investments at the IRR of the asset. Since that is the rate the taxpayer expects to earn, it is the rate the tax system must charge in order to prevent lock-in: If Sy can earn 20 percent with the money saved by deferring tax, and the tax system only charges 10 percent, he will tend to defer. Equivalently, the FAST could be said to be presuming that Sy does not have access to credit, and that to pay the tax he would sell a portion of the taxed asset.

with a 23.8 percent rate. Sy has already used up his $15 million lifetime FAST exemption amount.

Scenario One: Sy does not make the prepayment election. He holds onto Kick another 10 years and then retires, selling it for $6 million.

Scenario Two: Sy makes the prepayment election each year. To finance the tax payments, he takes out loans on which he pays a (compound) average rate of 10 percent. He holds onto Kick another 10 years and then retires, selling it for $6 million.

Results

Under Scenario One, Sy will owe the FAST at sale in the amount $2.08 million, leaving him with $3.92 million in net proceeds. Under Scenario Two, he borrows a total of $1.19 million and pays a total of $429 thousand in interest.[71] His net proceeds are $4.38 million.

Observation: The prepayment option is highly attractive for households that expect to earn returns better than are available to other market investors.

In other tax contexts prepayments have some further advantages for taxpayers. One of these is valuation. As we saw in Chapter Six, when taxpayers fight with the IRS over how much their property is worth, and that fight occurs at a time other than sale, taxpayers routinely win. Many taxpayers prevail without any fight at all, because no tax authority realistically can even detect all undervaluations.

A more obscure but important motive for very wealthy taxpayers to prepay some liabilities is to save on estate tax. Suppose a family owes a $60 million debt. If the parents pay that debt, it costs the family $60 million. If instead the parents leave the debt behind for their children, but bequeath cash to the kids to pay it, that debt will cost $100 million, since that is how much the parents must leave behind in order for the children to net $60 million after the 40 percent estate tax bite.[72] This is why families with wealth above the estate tax threshold would have been strongly incentivized to prepay BMIT liability before they died.

[71] His total borrowing is the $238,000 initial payment plus 10 payments of $95,200, or $1.19 million. His total interest payments are $238,000 + (45 × $9,520) = $429,000.
[72] The current estate tax mitigates this problem by granting estates a deduction for most liabilities of the decedent. I.R.C. § 2053(a).

All three of these factors can be calibrated to achieve the preferred amount of annual payments, but since all of them are to some degree costly for the government it is likely undesirable to maximize taxpayers' prepayment incentives. For example, if additional prepayment incentives are not needed, it likely does not make sense for governments to lose out on estate tax revenue from families who are savvy enough to pay tax debts before an individual dies rather than after.

As drafted here, the FAST offers Roth-like and estate tax incentives for households to make annual payments, but tries to avoid encouraging valuation games. In essence, letting taxpayers use valuation games to reduce their tax burden disproportionately rewards households with the resources and shamelessness to most aggressively work the system. Besides being regressive and inequitable, a system of somewhat randomly rewarding the least cooperative taxpayers can sap the sense of fair play and citizenship that strong tax systems rely on.

Thus, a condition of the annual payment regime is that electing taxpayers must accept the FAST's valuation rules. For non-traded assets that are hard to value, the rules provide that the taxpayer is bound to accept an IRS appraisal. Taxpayers would still have a right to appeal the appraisal, as the Due Process Clause requires, but there would be a strong presumption that the IRS value is correct. As Galle, Gamage, and Shanske (2023) explain in more detail, that presumption is consistent with judicial interpretations of Due Process because the taxpayer made the choice to subject themselves to the valuation rules in the first place.

Of course, we don't yet know whether most households will want to elect into annual payments under these rules. If further inducements are needed, the rate on annual payments could be set to be lower than the retrospective rate, exclusive of interest charges (for instance, a rate of 19 percent on annual gains or 20 percent plus interest on deferred gains).

Mandatory Interim Payments

In addition to allowing voluntary prepayments, the FAST would follow the BMIT in requiring households to sometimes pay tax on certain transactions prior to sale, mostly in order to protect the tax base from potential tax-avoiding transactions. A purely retrospective tax would be relatively easy to avoid through standard tax-planning techniques such as income stripping.

For instance, imagine that Avi Oider owns a small business, and as a result of a retrospective tax Avi will owe the government 24 percent of the value of the stock of that business when the stock is sold or otherwise disposed of. The business currently holds $100 million worth of assets. Avi might cause the business to take out a loan of $100 million, secured by the business assets, and pay out the loan proceeds to himself

as a dividend. He might then sell the stock, triggering the retrospective tax. But that liability will now be zero, because the net value of the business, and hence its stock, is now also zero. To be sure, Avi may owe income tax on the dividend he receives, to the extent that it is in fact taxed as a dividend under Section 301 of the Internal Revenue Code.[73] But the tax rate he will pay on the dividend will be at most 23.8 percent, less than his expected retrospective tax liability.

There are a few potential ways to handle these kinds of tax-avoiding payments. One approach would be again to wait until sale, and to increase the sale price by the amount of aggregate payments (usually dividends) that the taxpayer has received from the sold asset (Land 1996 considers but ultimately rejects this option). In Avi's case, for instance, his disposition of the stock at a value of $0 would instead be treated as a sale for $100 million, because he has received $100 million in dividends from the business.

There are at least three reasons not to rely solely on the retrospective method here, though. One is liquidity. Often, in a case like Avi's, the earlier dividend funds will have been long since spent by the time of a later sale, meaning that the sale may not generate enough cash to pay the resulting tax bill. A second is administrability (Glogower 2018). It may be costly and difficult for both the IRS and taxpayers to track what may potentially be decades' worth of payments from a property before it is sold.

The third reason is time, particularly as it relates to budgetary and political optionality concerns. All else equal, it's preferable to collect the tax sooner than later, and certainly within the 10-year budget window. Letting the Oider family defer tax on a $100 million dividend gives them both the incentive and the cash to push for enactment of a holiday to relieve them of their tax liability. And to the extent that retrospective taxation is motivated by a desire to fit with public intuitions about when to tax income, a partial cash-out of an existing investment for consumption purposes—that is, a dividend—probably fits into voters' intuitions about what income looks like.

As a result, the FAST instead treats these kinds of payments as, in effect, partial sales, subject to tax at the government's current deemed share of the sale proceeds. Recall that the FAST works by assigning the government a percentage slice of each asset's value, and that this percentage generally rises each year (with a potential further adjustment at the time of sale to account for basis). When interim payments like dividends happen, the FAST will impose a tax equal to this percentage times the amount of the payment. So in Avi's case, there would be a 24 percent tax.[74] If the payment is

[73] Distributions to shareholders that are not "out of earnings and profits" are only taxable as dividends to the extent that the distribution exceeds the shareholder's basis in their stock.

[74] Yale (2009) and Weisbach (2024) discuss in some detail a method for adjusting the shareholder's basis when dividends are taxed as sales. A complication in that approach is that it generally requires valuation of each class of stock, which is difficult for non-traded shares. However, as Land (1996) argues, and as Galle, Gamage, and Shanske (2023) show through simulations, accurate accounting for dividends and basis has little effect on ultimate tax liability in a retrospective system. Thus one additional appeal of the

already subject to income tax, then there would generally only be FAST liability to the extent that the FAST tax amount exceeds the income tax amount. If Avi paid $23.8 million in income tax as a result of the $100 million distribution, the FAST would require an extra $200,000 in tax. That isn't an essential design element, though. A FAST that was intended to closely replicate the revenue effects of a wealth tax, which typically would be imposed on top of the income tax, might not credit income tax liability against the interim charge.

Some distributions might be in kind rather than cash. Easily valued assets like publicly traded stock would just be treated as cash. For more complex assets, taxpayers could be given a choice similar to the options generally available under the FAST. That is, the taxpayer could treat the distribution as immediately payable, with valuation subject to the IRS-favorable rules described above for voluntary annual payments. Alternatively, they could defer tax on the value of the distributed asset, but the government would get a claim on the ultimate sales proceeds equal to the government's current claim on the underlying asset from which the distribution came.[75] For instance, if Avi's company paid him options with an uncertain value, he could elect to defer FAST liability on the condition that the government's share of the option proceeds would begin at 24 percent.

Sometimes distributions can be undeclared or implicit. Think of the business owner who spends $1 million from the corporate treasury on a vanity run for public office or a year's worth of personal travel on private jets. As the US corporate tax system recognizes, these kinds of uses of corporate resources are in economic reality dividends, and the "deemed dividend" rules generally tax them as such. The FAST piggybacks on these rules to also treat deemed dividends (or their equivalent outside the corporate context) as distributions subject to possible mandatory prepayment.

It's worth emphasizing that the FAST would only tax certain tax-avoiding payments, not every payment or secured loan. Specifically, the interim charge only applies if the taxpayer is using funds from their assets to make payments to themselves, or to related persons or entities they might be using as straw payees. The reason to omit payments to others is that presumably, when a business entity makes payments to unrelated third parties, it is getting back what it perceives as at least equal value. It would be difficult for the IRS to establish that the facts were otherwise. Taxing payments to related

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FAST is that it can implement the Yale (2009) method, thereby reducing the tax advantage for share buybacks over dividends.

[75] That is, if Shari receives $20 million in cash in a year in which the government holds a 1.99 percent share, she will have a tax bill of 1.99 percent × $20 million, or $398,000. If she instead receives stock in a subsidiary of her company, she would either (1) accept the government's appraisal of that stock and pay tax on that amount as if it were cash, or (2) treat the stock as though it were still subject to an ULTRA, even though it is no longer owned by the company to which an ULTRA was originally attached. If she opts for the second path, the government will take an immediate 1.99 percent interest in the distributed stock, the same as its share in the company that distributed it.

parties does mean that a self-employed individual who receives salary payments from their business may also trigger annual potential FAST liability. Since taxes on salary income for high earners will typically be much higher than the FAST rate, though, salary will rarely result in extra FAST liability.[76] A potential simplification would thus be just to omit compensatory payments from the mandatory prepayment rule, though this might instead lead to added complications from efforts to determine what counts as real or reasonable compensation.

The most difficult policy judgment is whether borrowing alone should trigger interim FAST liability. In the Avi example, it did not matter whether we treated the debt as an interim payment, because the debt was used to finance a dividend. Some debts, though, could serve to finance consumption or to strip value from an asset without an accompanying dividend or salary payment. Suppose, for instance, that Tex Dodger owns a diversified portfolio of highly appreciated stock with value $100 million. Tex pledges the stock as security for a $100 million loan. Technically, these loan proceeds are not dividends—they aren't payments from the companies in which Tex holds an equity interest. In most cases the loan will not reduce Tex's gains when the stock is sold; for example, if the lender forecloses, Tex will usually be deemed to have sold the stock for $100 million under the venerable case of *Crane v. Commissioner*. But the loan certainly will make it more difficult for the government to collect tax from Tex at the time of that foreclosure. Intuitively, it may also look as though Tex has found a way to consume the value inherent in the stock without first selling it.

These kinds of considerations led us to treat borrowing as an interim payment in the BMIT (see Galle, Gamage, and Shanske 2023 for more discussion), but in the current legal environment the risks and complications of treating borrowing as a deemed payment may exceed the benefits. As I discuss more in Chapter Five, it is somewhat uncertain whether the Supreme Court would see borrowing as part of the 16th Amendment's definition of "income."

On balance, it seems that the FAST can still operate fairly effectively without treating borrowing as a deemed sale. It's not clear if borrowing is a constitutionally acceptable occasion on which to tax. Many borrowing proceeds will already be subject to interim tax as dividends or the like, and thanks to the *Crane* case secured loans won't generally

[76] Treatment of deferred compensation deserves further consideration that is beyond my scope here. Preliminarily, it seems as though nonqualified deferred compensation would not necessarily have to be treated as an interim payment subject to immediate FAST. By definition, the nonqualified deferred compensation payment is made to an entity that is still subject to the claims of the business's creditors, including the government. On the other hand, a typical appraiser would not treat these funds as net assets of the appraised business, because they are subject to a claim by the employee. Deferred compensation promises might then serve as a form of value stripping, suggesting that they should be subject to interim payment treatment. Further, since they are plausibly a realization event, they might be taxed on the theory that the FAST should collect revenue prior to sale wherever constitutionally permissible.

reduce the amount of tax due at sale. Borrowing allows taxpayers to consume unrealized wealth, and conceivably that would in turn allow them greater leeway to delay sales until a political change that removed the threat of later liability (Galle, Gamage, and Shanske 2023). Fox and Liscow (2025) report, though, that borrowing is generally modest as a share of wealthy families' unrealized gains, suggesting that these concerns are also fairly small in scope. That means the main issue with borrowing is taxpayer liquidity—a real concern, but not an overwhelming one outside of secured debts.

Interim Payments and the Constitution

While there is a strong rationale for collecting some FAST payments before sale, that approach may face some degree of constitutional constraints. The legal analysis probably varies somewhat depending on the nature of the payment. Again, there are two distinct sets of payments. The first are optional prepayments by taxpayers who elect to cut short the FAST's interest accumulation. The second are mandatory payments aimed at blocking efforts to strip value out of assets subject to the FAST prior to sale. Each has somewhat distinct legal arguments in favor of its constitutionality, but both sets of arguments are fairly strong.

Optional prepayments are legal exactly because they are optional. The FAST imposes tax at realization, and it is only by the taxpayer's choice that payments would be made any sooner. The Constitution requires a "direct tax" to be apportioned, but the fundamental defining feature of a "tax" is that it is involuntary. Voluntary payments cannot be "direct taxes" because by definition they are not taxes at all.

More pragmatically, any rule that condemned FAST prepayments would also invalidate many quotidian tax administrative procedures that are unlikely to strike anyone as unconstitutional. Setting aside the FAST for a moment, imagine that Congress awarded a tax deduction to households that made a voluntary donation to the US, and that the deduction could be carried into later years by households without enough taxable income to use it in the year of the donation.[77] If voluntary FAST payments are unconstitutional, then so is this simple deduction system. The argument against the FAST payment presumably is that in the year of the voluntary prepayment, the household's tax is not measured by income. But the prepayment does not represent the household's tax obligation in the year of payment. Like our hypothetical tax deduction, it is just a voluntary contribution, which can be used to offset a future tax.

Similarly, many tax systems (including the US and most states) allow households to set aside their tax refund as payment against the next year's tax bill. Is this provision

[77] Of course, this system is not imaginary at all, but is the exact operation of the current IRC section 170, the charitable contribution deduction, which extends to gifts to governments.

unconstitutional, too? In the year of the set-aside, the taxpayer has voluntarily made a payment that is not measured by the current year's income, but instead is held by the government against future liabilities.

If these comparisons seem too far-fetched, consider the tax on PFICs. Again, a PFIC is typically a mutual fund operated outside of US jurisdiction. Before adoption of the PFIC regime, US investors could invest in these overseas funds and escape any US tax on the investment proceeds, at least until the time when the investor withdrew the funds: a self-help 401(k) with no contribution cap. The PFIC regime instead presents investors with a choice. At the time of withdrawal, the investor pays tax on their deferred gains, plus an interest charge that approximates the time value of money for the deferral. Alternatively, the investor can elect to pay tax annually on an MtM basis on their proportionate share of the fund's income, gains, and dividends.[78]

It is highly doubtful that the Supreme Court would find the PFIC rules unconstitutional. In the early 1980s, just before the PFIC rules were adopted, American investors were rapidly expanding their holdings of foreign mutual funds. Technological and cultural inhibitions on overseas investments are now far less constraining than they were then. A significant tax advantage for foreign mutual funds would likely drive hundreds of billions of investment dollars out of US institutions, potentially pushing many of them, and then the greater financial system, to the brink of collapse. Even the threat of this movement would be apt to spark runs.

Taxpayers challenging the FAST voluntary prepayments might argue that a PFIC's role as an anti-avoidance rule distinguishes it from FAST. That is, as we saw in Chapter Three, some Supreme Court justices might conclude that the 16th Amendment is consistent with narrow anti-avoidance rules that deploy MtM features, on the grounds that such rules have long been a feature of the US tax landscape and are likely essential to the system's functioning. That line of thinking might embrace the PFIC rules but still view voluntary prepayments with some skepticism.

But that approach would leave the Court in a strange place. Upholding PFIC rules under an anti-avoidance rationale would imply that *mandatory* prepayments are constitutional, to the extent they are needed to protect the effective operations of the tax system. And indeed, as we've seen, without some mandatory prepayments, it would be trivial for individuals with expected FAST liability to strip all the value out of assets subject to the retrospective charge, and the fisc would be at risk of coming up empty-handed if the taxpayer is bankrupt at the time of their later sale. It seems quite strange to say that mandatory prepayment obligations are constitutional but voluntary ones are not. Further, voluntary prepayments serve some of the same anti-avoidance purposes as mandatory payments do. For instance, voluntary prepayments help to

[78] As with nearly all things in the IRC, there is more detail here, as not all PFICs meet the conditions required for an MtM election. *See* Treas. Reg. 1.1295-1.

reduce the risk taxpayers will be bankrupt at the date they sell their asset, preventing any tax payment.

These arguments assume that a court would see prepayments as "voluntary" rather than as a coerced agreement, and that seems like a fairly safe assumption. There is no extra penalty imposed on households that choose to wait until sale; they simply pay the equivalent of an interest charge imposed at the same rate at which their own asset is appreciating—by definition a market rate. Over long periods any interest rate, even a nominal one, can add up, but at the time a taxpayer makes the election we don't know how long they plan to keep their asset. What we know is that they are saving themselves at least one year of interest: if they are prepaying this year, it must be because they haven't sold the asset yet.

It also is doubtful that courts could reach the merits of a challenge to voluntary prepayments, because no challenger would have legal standing to bring suit. Federal law only opens the courthouse doors to plaintiffs with a "concrete and particularized injury." A plaintiff cannot bring a suit if victory would not plausibly remedy their injury. What could a taxpayer faced with the FAST's voluntary prepayments or the PFIC's optional MtM regime hope to win? Win or lose, they will still have an obligation to make payments later, likely at higher cost. All that winning achieves is to take from themselves the chance to do better by paying sooner.

Perhaps some other plaintiff might argue that voluntary prepayments injure them by giving away money from the public fisc. That is, by assumption, taxpayers who exercise the prepayment option will only do so if they see themselves as better off. That is why they lack standing to sue. But this means that prepayment likely reduces public revenues, at least in the expectations of the electing taxpayer. Could that be an "injury" that would allow other individuals to bring suit? No. The Supreme Court has said repeatedly that a person's generalized interest in higher revenues cannot supply standing to challenge government decisions that favor another taxpayer.

States probably could not sue, either. A number of US states have tax codes that mirror federal law, so that a money-losing prepayment option could arguably be said to damage their interests (even as it helped protect them against bankruptcy and other risks). Yet it is highly unlikely the Supreme Court would let the states proceed on such a theory. If that were the law, then states like New York, New Jersey, Vermont, or Massachusetts could routinely challenge IRS administrative decisions that favored federal taxpayers.[79] That would mark a sharp rupture from historic practice, in which the government has been free to give away money through administrative decisions, without any threat of judicial oversight (Galle and Shay 2023). The closest analogy is probably the Court's landmark 2007 decision in *Massachusetts v. EPA*, in which it

[79] Massachusetts and Vermont currently conform only to the 2024 version of the IRC, so they would not be affected by a new FAST provision unless their legislatures acted to update the reference date.

allowed states recourse to federal court to address greenhouse gas emissions. But the present Court has tried to edge farther and farther from that precedent, which was authored by the late Justice John Paul Stevens.[80]

The mandatory prepayments I've proposed would be an easier case for standing, but, again, their constitutional status mostly seems straightforward. The Court would very likely approve targeted anti-abuse rules that employ some MtM elements, to the extent that an otherwise lawful system could misfunction without them.[81] In addition, the prepayments are mostly triggered by events, such as dividends and salary payments, that the Court has said are realization events. Even under *Macomber*'s antiquated standard, dividends or other cash payments are clearly a separate "fruit" of the underlying investment that the taxpayer can use for their benefit.

Even if there were some potential constitutional problems with the various interim payments, that wouldn't have to doom the whole FAST project. The bill could be drafted with severability provisions directing that if interim payments are not "income," then only the retrospective provisions would remain, and tax-avoiding payments could be added back to sale price. That obviously would not be ideal, for the reasons I've described, but would still be better than the status quo.

For some payments, apportionment might also be a viable option. Recall that the 16th Amendment lifts the constitutional requirement that direct taxes be apportioned according to state population. The bill could include a fallback provision that directs that if courts hold that interim payments are not "income" under the 16th Amendment, and that they are "direct" taxes that have to be apportioned, then they will in fact be apportioned.

The rate on an apportioned tax in interim payments would have to be scaled up or down in each state to reflect that state's share of the national population. That is certainly strange, but if the main point of a tax on interim payments is to discourage tax avoidance, the exact rate of the tax may be less important. Retrospective taxes could then include an adjustment at the time of realization that equalizes the effective rate all taxpayers face.[82]

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[80] For example, a court could distinguish *Massachusetts v. EPA* from the FAST by noting that in the Clean Air Act instance, the Court's opinion highlighted the fact that states were directly damaging one another with their emissions, but the Constitution prevents the injured states from taking responsive action.

[81] Another analogue here is the Court's decision in the famous case of *Crane v. Comm'r*. There the Court agreed with the IRS that a taxpayer who transferred a property subject to a liability had to include the value of the liability in the sale price. Without that rule, it would be easy to acquire real estate with leverage, claim depreciation deductions, and then also claim a loss deduction at sale. Thus, although the Court wasn't fully certain whether the transfer of a debt was really 16th Amendment "income," it agreed with the government's rule because, it said, the 16th Amendment does not require that taxpayers get double deductions. *Id*. at 15.

[82] Apportionment would pose a fun constitutional hypothetical for Washington, DC residents, though, whose license plates declare, "No taxation without representation." Article I, cl. 2, § 3 of the Constitution

FAST, BMIT, and the Constitution

Because I've argued that the Constitution is one of the main reasons to favor the FAST over the approach of Rep. Cohen's BMIT bill, it's worth pausing to compare our constitutional assessment for the two. Again, the FAST is something of a mirror image of the BMIT, in that, broadly speaking, both allow taxpayers to elect when to pay tax, and use a retrospective system with the equivalent of interest charges to assess tax for those who opt to pay later. But by default the FAST imposes taxes at sale, with an option for annual payments, while the BMIT is imposed annually with an option for deferral.

Does the difference in default make any constitutional difference? Certainly there is a good argument that it should not. The BMIT should be constitutional for the same reason the FAST is: Taxpayers are only taxed annually if they choose to be. Both are similar in terms of when they mandate prepayments for anti-avoidance purposes, although I have suggested the FAST would not tax borrowing. The FAST perhaps offers better "optics" to appeal to judicial intuitions, in the sense that it can be framed as a tax imposed at sale (with minor exceptions), whereas the BMIT might be framed by opponents as an MtM tax (with minor exceptions).

If there is a significant legal difference between the two (viewed at this level of generality), it may lie in the rights of potential challengers to bring suit. As I've argued, it's likely no one would have standing to block the FAST's voluntary payments, because all that the suit can accomplish is to take away the taxpayer-plaintiff's own choice to accelerate payment. In contrast, a claimant could likely proceed against the BMIT by arguing that its baseline tax, the annual payment, is not constitutionally permitted. That is, if the taxpayer option in the FAST were struck down, the taxpayer would still be obligated to pay tax at sale, and would be no worse off. If the taxpayer option in the BMIT were struck down, there would arguably be no remaining obligation, only an option to defer a nonexistent tax, and so perhaps the prevailing taxpayer would have succeeded in eliminating their tax liability. That would give them standing to sue.

One other key difference between the proposals is that the BMIT limited the deferral option to "illiquid" taxpayers. In effect, the BMIT mandates MtM treatment for households that hold at least 20 percent of their wealth in the form of traded assets. The wealth tax bills introduced in 2021 in California, which offered similar deferral provisions, obligated even those who elected deferral to still make small annual down payments against their ultimate liability. While there are strong policy rationales for

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says that direct taxes have to be apportioned "among the several States which may be included within this Union." Would DC and territorial residents be exempt from an apportioned tax? They weren't exempt from 19th century apportioned taxes. See, for example, Act of August 5, 1861, ch. 45, 12 Stat. 292, 294. But those seemingly were not subject to legal challenge.

both these approaches, neither would be likely to survive if the Court held that the 16th Amendment concept of income requires realization in most cases. If apportioned interim payments are seen as viable, perhaps they could be a fallback option, though. I view this as a fairly unlikely outcome.

Concluding Thoughts

The FAST is a tax system for our political and constitutional moment. By charging more tax for more highly appreciated property, it obliges ultra-wealthy households to pay their fair share of the benefits that massive wealth accumulation provides over time, closing a long-standing and growing loophole in our current system. Quite possibly the ideal bill would rely not only on the FAST's retrospective valuation and voluntary prepayments, but also more expanded mandatory prepayments, as proposed in Galle, Gamage, and Shanske (2023). That approach, though, would increase the risk that the bill would be found unconstitutional, and is perhaps less intuitive to voters who favor realization-based approaches.

Chapter Nine: Retrospective Taxation for Intergenerational Transfers and Trusts

- Imposing a higher rate of tax on very large inheritances is consistent with the long US history of the estate tax as well as making good economic sense.

- The FAST can replace the existing estate and gift tax by adding a 40 percent government interest in inherited property in excess of $15 million.

- The inheritance FAST is triggered when inherited assets are sold, ending the valuation games that trouble the estate tax and easing political resistance to "death taxes."

- FAST blocks standard "estate freeze" techniques by taxing gifted assets at sale, not date of donation, and assigning liability to the donor.

- Heirs and trusts of large estates would make annual prepayments of 1 to 5 percent of approximate asset value, and this would be consistent with the 16th Amendment.

We have seen that a retrospective tax system must, like us all, account for death. This chapter explores how the FAST can be integrated with a carryover basis regime in which death is not a realization event but heirs do not escape from, and indeed continue to accumulate, FAST interest charges. It also details crucial anti-abuse rules aimed at preventing the exploitation of trusts and similar tax-planning devices.

In addition, I argue that we should repeal the estate tax and replace it with an additional 40 percent FAST bracket for inherited wealth in excess of $15 million. That is essentially an implementation of the Batchelder (2009) inheritance tax proposal, but applied broadly to all taxable estates, with additional interest charges and safeguards. Chapter Six argued that there are strong economic arguments for eliminating the basis step-up at death and taxing inheritances. But that chapter also noted that imposing tax at death is politically unpopular and administratively challenging. Retrospective taxation through the FAST can help to square this circle by moving tax collections away from the time of death, mitigating liquidity concerns, and sharpening the government's ability to determine what an estate is worth. An inheritance tax can also constitutionally impose annual prepayments against ultimate liability, which the FAST would implement for large inheritances.

That is, the FAST can be integrated with a system of inheritance taxes through continuing FAST liability for heirs, and adding an additional 40 percent government share (of the portion not already notionally owed to the government under the FAST) at inheritance. Since the implementation of the two is tied closely together, I will first explain the rationale for imposing an additional tax on vast inherited wealth. I emphasize, though, that either system, or even subcomponents of them, could also be adopted independently, as in the case of the Fair Trusts Act, a bill from Sen. Patty Murray (D-WA) and Sen. Wyden that would implement the trust taxation reforms I describe here.

Why Tax Inheritances More?

In Chapter Six, I reviewed the economic case for taxing inherited wealth. Overall, we saw that there is a strong case for taxing inherited wealth more heavily than other forms of accumulation. For example, one key rationale for taxing investment income is to account for the vastly disproportionate power and influence that ultrarich Americans now enjoy. This rationale is even more apt for inherited wealth. In addition to distorting current policy, inherited wealth undermines our commitment to equality of opportunity by granting unique privilege at birth to the ultra-wealthy few, which in turn can discourage and demoralize everyone else.

Does that story align at all with the current design and structure of the US system for taxing inheritances, though? Indeed, it does, as the next subsection reviews.

Historical Background

As originally conceived, the estate tax was intended to protect us against the power flowing to those with massive fortunes accumulated during America's Gilded Age. "The really big fortune, the swollen fortune, by the mere fact of its size, acquires qualities which differentiate it in kind as well as in degree from what is possessed by men of relatively small means," President Theodore Roosevelt explained in 1910. "Therefore, I believe in a . . . graduated inheritance tax on big fortunes, properly safeguarded against evasion, and increasing rapidly in amount with the size of the estate."

Roosevelt was out of office in 1910, but his was still a leading voice of the political movement that gave birth to both the income tax and what was then called the inheritance tax. Roosevelt spoke for a broad and growing national opposition to "plutocracy," the rising power of vast nation-spanning businesses controlled by a handful of the ultra-wealthy. This sense of unease with the nation's new and massive inequality had also been an important impetus for the 1894 income tax, which was infamously struck down by a conservative Supreme Court in 1895. After academic studies found that the country's wealthiest 1 percent owned about two-thirds of

national wealth, the populist movement pushed tax instruments that would "attack growing concentrations of wealth." The 1894 income tax thus included a version of the inheritance tax, which supporters saw as essential to efforts to tax an individual's "ability to pay."

After the 1894 tax was struck down, wealth concentration continued apace, further driving public concern. Waves of corporate consolidation threatened the felt economic security of local manufacturers and merchants. Advocates drew on these sentiments in support of taxes on both inheritances and income more generally, pointing to the dangers of "robber barons" who were the beneficiaries of wealth concentration. Many commentators warned about not just the economic but the political danger of concentrated wealth, arguing it came with concentrated political power that threatened traditional republican values. Indeed, in the eyes of Roosevelt and many others, support for the inheritance tax was not a radical project but a conservative one, aimed at maintaining the familiar open character of American politics and forestalling pressure for more dramatic redistribution. Between 1894 and 1913, many states adopted their own inheritance and corporate income taxes as part of an effort to reduce economic concentration.

During Roosevelt's campaign to return to office in 1912, he ran on a platform to enact both the income and inheritance taxes. Though he lost, there was by then overwhelming support for a new tax system, with its principal architect, the Tennessee congressman (and later Secretary of State and Nobel Peace Prize winner) Cordell Hull. Surprisingly, Hull's bill exempted inherited wealth from the definition of income, and perhaps this is what has led other commentators to conclude that he did not see inheritances as part of the project of taxing concentrated wealth.

But that is not so. Instead, Hull exempted inherited wealth from income because he wanted a heavier and more progressive tax on inheritances, and he was preparing a separate bill to accomplish those goals. That bill did not arrive until 1916, as part of an effort to meet the expense of World War I. Introducing that provision on the floor, Hull explained that he initially believed state inheritance taxes could accomplish his goals, but that continuing experience with cross-border tax avoidance had convinced him it was only administratively practicable at the national level. He also noted that it was an efficient source of revenue that was unlikely to affect wealth accumulation. And at his back, politically speaking, was a nationwide movement discontent with wealth concentration and the political power of vast businesses, the "industrial feudalism" of the Rockefellers, Morgans, and Vanderbilts. Advocates backed the inheritance tax—now, technically, an estate tax in Hull's bill—to "check the growth of a hereditary aristocracy menacing to democracy."

Two decades later, Franklin Delano Roosevelt built on his cousin's legacy, introducing reforms that expanded the estate tax and made it more progressive. Explaining his

work, FDR said that, "The transmission from generation to generation of vast fortunes . . . is not consistent with ideals and sentiment of the American people . . . such accumulations amount to the perpetuation of great and undesirable concentration of control in a relatively few individuals." Congress agreed, with legislative history indicating that the purpose of the expanded tax was to break up large estates.

In short, the origins and continuing history of the wealth transfer tax system, in the vision of two Presidents Roosevelt, was to defeat dynastic power. That is, the tax should discourage the concentration of *inherited* wealth and power in a relatively small group of the most powerful.

FAST Inheritance Taxes

So there is a compelling case for taxing very large inheritances, whatever other fixes we might make to taxing investment income. We saw in Chapter Six that the current US regime for taxing inheritances—which combines taxes on decedents' estates with taxes on gifts and generation-skipping transfers—is easily manipulated. Though it is an exaggeration to say "only morons pay the estate tax," it is mostly unlucky or indifferent families who pay (Galle, Gamage, and Lord 2025).

I propose to repeal the estate tax, but replace it with an additional bracket within the FAST system. The government would get a 40 percent interest (the current estate and gift tax rate) in all inherited property in excess of $15 million per heir.[83] If integrated with the Chapter Eight FAST, the government share would be 40 percent of the portion that is not already notionally assigned to the government (for instance, if the notional government share were the default 11.9 percent under the FAST, the inheritance FAST would be an additional 40 percent × 88.1 percent = 35.24 percent interest). This rate and exemption amount could be adjusted for revenue or other purposes, such as evidence about the social damage associated with inherited wealth. As a result, heirs would not necessarily pay tax when they inherit, but would instead pay when they sell any inherited assets.[84] Collecting this amount through the FAST system would mean that the heirs who delay payment would in effect pay interest at the internal rate of return

[83] This exemption amount is not depleted by use of the FAST exemption for capital gains, and vice-versa. As with the FAST, the $15 million exemption is used up when assets are sold, so that a sale for $15,100,000 would result in $40,000 of tax liability.

[84] Some wags might suggest that including this deferral option makes the term "FAST Inheritance Tax" an oxymoron. But under prevailing estate tax planning, families routinely delay any estate tax or GST payments for two or more generations. The FAST is swift in comparison.

on their inherited assets.[85] As under the FAST generally, property owners could always opt to settle the FAST bill before sale to reduce later interest payments.

Example 9.1: FAST Inheritance

Dynasty Family matriarch Krystle dies, leaving $10 billion worth of stock of the privately-held company Denver-Carrington to her daughter, Fallon, who has already exhausted her lifetime $15 million inheritance tax exclusion amount. The applicable government share of the inheritance FAST is 40 percent. Ten years later, Fallon sells one-fourth of her inherited Denver-Carrington shares for $6 billion.

Results

Fallon owes nothing when Krystle dies but will owe $2.4 billion in inheritance FAST when she sells the shares. Of this amount, $1 billion represents the 40 percent tax she would have owed under a traditional estate tax (40 percent × ¼ × $10 billion). The remaining $1.4 billion is an interest charge. The Denver-Carrington stock increased in value from $10 billion to $24 billion, an increase of 140 percent, for a (compound) rate of return of 14 percent per year. A 14 percent interest charge on $1 billion is $140 million, multiplied by 10 years, totaling $1.4 billion.

Observation: Fallon would likely have benefited significantly from an election to settle the inheritance FAST close to the time she received the stock.

While there are other proposals to repair the estate tax, or roll out an improved inheritance tax, the FAST approach has some structural features that make it more likely to succeed than existing proposals. Prior commentators argue that taxes on heirs are more intuitive and morally defensible than the estate tax (Alstott 2007; Batchelder 2009; Fleischer 2006). In addition, unlike some inheritance tax structures, the FAST

[85] Conceptually, we would only want heirs to pay interest based on appreciation after the date of inheritance. To implement that ideal, the FAST would need to be able to accurately value assets at the date of death. It is possible that no special rules would be needed for this valuation measure, because families will have mixed incentives, in which it may be useful for FAST inheritance purposes to assert a higher valuation but otherwise preferable to assert a low valuation. In any event, families will have very strong incentives to voluntarily resolve any open FAST liability for estate assets in the last year of the decedent's income. The FAST would permit estate administrators to make such an election, and could even make the election an opt-out default to avoid trapping the unwary in the highly disadvantageous tax situation that would result from failure to make the election. If families make the prepayment election, they will have to accept the favorable valuation rules of the voluntary FAST prepayment system, which should help to ensure that any measure of post-inheritance valuation begins with an accurate value at the date of inheritance.

shifts liability for the tax to a time other than the death of the taxpayer, so that it is no longer a "death tax."

Yet another advantage is that the FAST determines asset value through actual sales, or at least valuation on terms mostly chosen by the government. The availability of real sales data makes it much more difficult for taxpayers to manipulate the valuation of their property. The FAST thus builds on the suggestion in Batchelder (2009), which would have permitted deferral until sale in certain limited cases. Responses aimed at repairing the valuation-at-death system (e.g., Belcher and Fellows 2004) require a complex patchwork of special valuation rules, and would be vulnerable to any future innovations in valuation games that taxpayers have not yet resorted to. The government will always be playing catch-up when it has to value assets on taxpayers' terms without hard evidence of sale price. That is largely the lesson of international experience with "transfer pricing" between related corporate entities (Fleming, Peroni, and Shay 2009; Kleinbard 2011).

In effect, the FAST is a form of carryover basis, but as Chapter Six noted, the central criticism of carryover basis is probably no longer a concern, if it ever really was. Critics of the 1976 carryover basis rules argued that it would be prohibitively difficult to track basis across generations. Today, though, financial institutions are required to track and report basis to investors. Small businesses already must track investors' basis in order to determine whether annual profits distributions to the owners are taxable (for example, under IRC § 731). If the FAST regime is limited to higher-earning households, it is unlikely that the affected taxpayers will have to spend much time on their own combing the attic for tax records. If some concerns still remained, commentators have suggested exemptions for low-value personal property and rules for approximating basis with purchase-period value, would make implementation even easier. The remaining weak point of carryover basis, its poor revenue score, is mitigated by the FAST approach, which imposes interest and so no longer has the vulnerability of encouraging heirs to hold assets indefinitely.

A retrospective inheritance tax is easier to implement, though, if it is only a part of a larger reform that includes retrospective taxation of other investment assets. If only inherited or gifted assets are subject to the retrospective tax, then owners of those assets might try to strip value out of their inherited property, such as through below-market sales of an inherited businesses' assets to another business owned by the same taxpayer. Our tax system already includes several sets of rules for limiting these kinds of value-stripping tactics. Making those rules work does require vigilance and enforcement effort for the IRS. The demands on the IRS would be much lower if there were little for taxpayers to gain in stripping value from inherited assets to other assets, as would be the case if all of the taxpayer's assets will be subject to the retrospective tax.

FAST Inheritance Interim Payments

As with the FAST proposal of Chapter Eight, an estate or inheritance tax implemented through the FAST should include some withholding taxes that are payable before the asset is finally sold, and those rules are actually much easier to put in place for an estate or inheritance tax regime. Again, policymakers should strongly prefer to collect revenue sooner than later, even if taxpayers are being charged an interest charge that reflects the time value of money. Up-front payments mitigate concerns about bankruptcy priority, political economy, and the 10-year budget window, as well as discouraging efforts at tax avoidance. Policymakers could require small annual down payments toward the ultimate liability, such as 5 percent of the expected tax. Because this would just be a down payment, the amount due could be calculated using a highly simplified approach to valuation, such as basis plus an inflation adjustment. In addition, taxpayers who receive dividends from an inherited company, or who otherwise make use of inherited funds, should typically owe an immediate tax equal to the government share times the amount of the distribution, in addition to any income tax consequences of the dividend. These payments would also be credited against the ultimate inheritance tax liability.

When the FAST was part of the income tax, there were potential constitutional concerns with some of these kinds of withholding taxes, but that does not matter for an inheritance tax. The Supreme Court might be open to arguments that a tax collected prior to realization is not "income" under the 16th Amendment. But the Supreme Court twice upheld the constitutionality of unapportioned inheritance taxes before the 16th Amendment was ever adopted, on the theory that a tax on inheritance is an "indirect" tax that does not need to be apportioned—basically a sales tax on inherited assets.[86] That frees Congress to collect on the sales tax bill any time after the taxable transaction has occurred. A withholding tax against the ultimate inheritance FAST liability occurs before the heir's sale, but after the inheritance, so it's just a deferred payment of an inheritance tax.

This timing flexibility would also allow Congress to offer heirs the opportunity to prepay their inheritance FAST liability. Presumably heirs will choose a time to resolve the bill that permits them to argue for a relatively low valuation. This kind of taxpayer control is exactly why the estate freeze is so effective at undermining the estate tax. Perhaps accelerating the timing of payments is valuable enough to policymakers that they are willing to offer a deal on the extremely favorable terms estate planners now exploit. It seems likely, however, that Congress could instead grant some modest

[86] Recall that the 16th Amendment allows Congress to collect "direct" taxes without apportioning them by state population. Direct taxes are generally taxes imposed on the mere existence of a taxpayer, or on their ownership of property, without respect to how that property is used. In contrast, the category of "indirect" taxes includes those that are imposed on a particular transaction or use of property, such as a sales tax or a tax on the choice to do business through a corporate entity.

prepayment flexibility while limiting the extent of valuation abuses, and many taxpayers would still elect to prepay. As Example 9.1 illustrates, heirs who hold rapidly appreciating assets, or hold any asset for long periods, may well end up facing interest charges bigger than the tax bill itself. Those heirs should often be quite open to the chance to settle their bill and cut off further interest accumulation.

Accordingly, if Congress allows heirs to prepay their inheritance tax, it should do so under a valuation regime that much more strongly favors the government. Without a realization event available for reference, the valuation of the estate will often be open to dispute, and as we have seen taxpayers usually prevail in those contests. A prepayment regime could instead require taxpayers to accept the government's appraisal, unless the taxpayer could show highly convincing evidence that the government is wrong. Galle, Gamage, and Shanske (2023) explain that although courts have sometimes read the Due Process Clause to prevent the government from stacking the valuation process this way, the fact that taxpayers can always elect to pay later greatly eases that concern.

Integration with the FAST

Congress can use a similar set of methods to replace the basis step-up at death, and indeed it would probably have to do so in order to make a FAST effective. A FAST probably cannot defeat lock-in incentives if taxpayers know they can eliminate all their tax by holding appreciated assets until death. A deemed realization at death regime is hard to administer and likely to be fairly unpopular, as Chapter Six discussed. The alternative of carryover basis—making the heirs liable for their parent's liability—is plausible but creates lock-in for heirs, unless they, too, will be subject to the FAST regime. My proposal, then, is simply to continue the FAST for heirs, with the clock continuing to run on inherited assets. This idea can also be implemented as a freestanding reform, such as in the case where repeal of the basis step-up is paired with treating borrowing as a deemed sale. In that case, adding the FAST-like feature to carryover basis cures carryover of one of its most serious problems, which is the continued incentive of heirs to hold assets until their own deaths.

Example 9.2: Interest Accumulation Under the FAST

Dynasty Family Matriarch Krystle is the founder of a privately held business called Denver-Carrington. A FAST is in effect with a 20 percent tax rate and a 5 percent expected average rate of return, granting the government a roughly 1 percent ownership stake in each year that Krystle holds her stock of Denver-Carrington. After 15 years, Krystle dies, leaving her stock to her daughter Fallon. Under the FAST rules the government's stake continues after inheritance. Five years after her

inheritance, Fallon sells the Denver-Carrington stock for $5 billion. At this time, the government's stake is 20 percent (15 years × 1 percent + 5 years × 1 percent), so Fallon's tentative liability is $1 billion, and Fallon's exact liability will depend on Krystle's basis and the result of the retrospective tax calculation.

In a bill in which both the FAST and the FAST inheritance are adopted, the 40 percent bracket for inherited property would be added to any existing government share accumulated by the decedent or heirs. Thus, for example, an heir who has exhausted their $15 million exclusion amount and then inherits an asset subject to a deemed 11.9 percent government share would have a notional inheritance government share of 35.24 percent (40 percent of the taxpayer's residual 88.1 percent interest) for that asset. Chapter Ten discusses in more detail methods for mitigating the potentially large combined tax burden that would result. Current law, for example, sometimes attempts to cross-credit certain income and estate tax burdens. Briefly, as long as estates have the option to resolve open FAST liability in the last year of income for the decedent, it will be strongly in the interest of the heirs for the executor to do so. Heirs should therefore not typically receive property with any unresolved FAST liability, except for the 40 percent inheritance FAST.

Retrospective Taxation and Freeze Transactions

The retrospective method also helps to address freeze transactions. Again, in a typical freeze transaction the taxpayer transfers assets, at relatively low valuation, to a trust, paying gift tax as a result of the transfer. The trust is outside the taxpayer's estate, so no further tax is due when the taxpayer passes under either an estate tax or deemed realization at death. These methods can undermine any efforts to tax at death, whether through an estate, inheritance, or deemed realization at death tax.

Though there are several potential responses to these kinds of tactics, the FAST's primary strategy is to require the transferor to remain responsible for FAST payments. Chapter Ten explains in detail how that mechanism would operate and why it is likely preferable to others, such as the possibility of treating gifts as realization events.

In the case of deceased transferors, the transferees of a taxable bequest would pay additional transfer taxes under the retrospective method. That is, if an heir receives stock that was taxed at a relatively low valuation at the time of a gift, and then the heir later sells the stock at a relatively high valuation, the heir will owe additional inheritance tax at the time of sale, with an interest charge reflecting the asset's appreciation since the time of the gift. Heirs who hold assets past the date of death of the transferor may end up paying interest charges based on appreciation that occurs after that death, leaving them worse off than they would have been had they simply

paid estate tax instead. It would be better, however, if the law did not incentivize fire sales. Thus, the FAST provides that heirs who want to end further interest charges can elect to instead prepay tax at or after the time of the initial transfer, but under the government-favorable valuation regime that generally applies to FAST prepayments.

Example 9.3: Interest Charges Under Inheritance FAST

Family Matriarch Dua L. is the founder of a privately held business called DualCo. Dua believes that the next round of venture funding for the business will value her equity stake at more than $1 billion, but this information is not public. Dua causes DualCo to issue a new class of stock ("DualCo Senior"), which does not participate in dividends but will hold 75 percent of shareholder voting power. Any growth in value of DualCo is expected to accrue in the original class of stock ("DualCo Junior"), because that class of stock is entitled to receive distributions of corporate profit. Dua contributes her shares of DualCo Junior to the family trust T, and takes the position on her gift tax return that the stock is worth $13 million. Because this amount is less than Dua's lifetime estate and gift tax exemption of $15 million, she pays no gift tax at the time of the transfer. The IRS does not audit Dua's gift tax return within the three year statute of limitations.

Dua's husband predeceases her. At the time of Dua's death, the DualCo Senior stock she owns directly is worth $10 million and the DualCo Junior stock held by T is worth $10 billion. In order to make life estate distributions to Dua's children, the trustee of T sells $2 billion of DualCo Junior stock. Assume that 30 years have passed since the date of the initial funding of the trust.

There is a retrospective tax regime in place for gifts but the law is otherwise as under the 2025 IRC. The T trustee did not elect to pay tax at the time of the initial gift. Thus, the government took a 40 percent stake in the DualCo Junior stock.

Results

Upon sale, T will owe 40 percent × $2 billion = $800 million in additional estate tax. This represents the initial $80 million in tax Dua should have owed on a properly-valued gift of this portion of her initial transfer of the DualCo Junior stock (2/10 × 40 percent × $1 billion), plus interest. The rate of interest charged is the compound return of the DualCo Junior stock, which is 33 percent per year (1000 percent increase / 30 years).

Example 9.4: Sale of Inherited Assets Under Inheritance FAST

Same as 9.3, but the trustee of T sells $1 billion of the DualCo Junior stock at the time of Dua's death, when the stock in total is worth $5 billion.

Results

T owes a retrospective tax of 40 percent × $1 billion = $400 million. The T trustee distributes the remaining $600 million to Dua's daughter, DJ.

Observation: If instead Dua had never gifted the DualCo Junior stock, and 20 percent of that stock had passed directly to DJ at Dua's death, the stock would have been subject to the estate tax. Dua's estate would have owed a 40 percent tax, leaving $600 million worth of stock for DJ, the same as under the retrospective gift tax. Thus, as long as heirs sell or otherwise settle their retrospective gift tax liability at the time of the transferor's death, they will face identical tax liability under either the retrospective gift tax or the estate tax.

Implementing retrospective taxation adds record keeping and other compliance costs, and so it would be preferable to impose it only for a relatively select set of transfers. Gifts that are too small to trigger gift tax today (those under about $19,000) could similarly be entirely exempted. Under current law, the gift tax is only payable on larger gifts once the transferor has made lifetime gifts in excess of their estate tax threshold, or about $15 million per person in 2026. For a new retrospective gift tax, that approach would add complexity, as well as planning opportunities similar to those available now under the GST (that is, planners would attempt to gift assets that were most likely to appreciate first, so that they would benefit from full exemption). A simpler and less manipulable approach would be to have the retrospective gift liability count against the exemption amount of the transferor, as Chapter Ten details. If the bill instead assigns liability to the transferees, Congress might reduce the amount that is exempt for this purpose, as that would allow planners to multiply the gift exemption by splitting gifts among several recipients.

An anti-freeze rule is easy to integrate with a generally applicable FAST. As long as the retrospective tax clock continues to run for trusts and other heirs who receive property in kind, gifts will not operate as freezes, because interest will continue to accrue as assets appreciate.

Taxation of Trusts

Trusts offer tax planners several useful loopholes, as Chapter Six detailed. Perpetual trusts, in particular, allow families to transmit ongoing control of a family business, and meet the lifestyle needs of future generations, without ever paying estate tax. The GST would, in theory, collect revenues at estate tax rates for transfers to later generations, but under current law many trust distributions are exempt from the GST because the trust's initial value was less than the GST exemption amount. Again, Galle, Gamage, and Lord (2025) estimate that more than $5 trillion in wealth is currently held by trusts that would be subject to estate tax liability but instead are perpetually exempt from estate and GST tax. A trust is also a useful potential place to stash assets for planners aiming to sidestep a deemed realization at death.

Congress should reform trust taxation to eliminate any tax incentive to employ trusts. While there are several routes to this result, many of them would require a complex set of targeted patches to existing law. A simpler approach would be an annual withholding tax on wealth held in trust. The tax would be a "withholding" tax in the sense that it would be creditable against any estate tax liability the trust or heirs do incur. Obviously, trusts that today are perpetually exempt from estate tax and the GST would not find this credit useful, so that the withholding tax would serve to replace the estate tax burden those trusts are designed to avoid.

In addition, if Congress adopts the FAST, trusts would also be subject to that system, and the interest clock would continue to run on assets transferred to a trust.[87] The FAST does not eliminate lock-in if there are places taxpayers can shift appreciated assets without paying the interest charge. As we have seen, Canada attempts to address this planning opportunity by making gifts realization events. But in the absence of a real sale, taxpayers appear to have little difficulty manipulating the appraisal of gifted assets. The FAST (with an option to prepay under terms favorable to the government) mitigates that tactic.

Example 9.5: FAST Plus Trust Withholding Tax

Same as Example 6.4. If there is a trust withholding tax in place, the trust, T, will make annual withholding tax payments. For simplicity, suppose that the annual payment amount for T is $200 million. If T has made $1 billion in payments at the time it distributes the DualCo Junior stock to DJ, it will also transfer $100 million in credits, a 10 percent share of its overall tax credit, to D (see Galle, Gamage, and

[87] Again, my default rule would be that FAST liability would remain with a living trust grantor, but I expect that most planners would shift that tax burden to the trust by contract. As Chapter Ten details, trusts could also be held jointly and severally liable for unpaid FAST taxes of their grantors.

Lord 2025 for details of the credit system). Assume that DJ's heirs elect to settle the estate tax liability immediately rather than deferring.

Results

DJ's estate will reduce its liability from $389.6 million to $329.6 million (the credit is includable as part of DJ's estate, so after taking account of this added tax liability DJ's estate saves $60 million). DJ's heirs will continue to be liable for FAST payments on the built-in gains in the $1 billion of DualCo Junior stock, unless they also elect to resolve that government claim immediately as well.

When Hijo dies, there is no GST liability because the trust is GST-exempt. Suppose that at this date T has made $2 billion in payments, with $1.9 billion remaining in credits. Under the withholding tax rules, because the trust is GST-exempt, the tax credit account will be reset to zero at the time Hijo dies.

Observation: In order to make some use of its credit, the trust must make distributions to beneficiaries.

Annual payments plus a FAST are preferable to the alternative common to many reform proposals, such as the Canadian system of deeming the trust to "die" every 21 years, in which all trust assets are very occasionally taxed in full. A US example is the proposal from Sen. Warren under which trusts whose organizational documents permit them to continue to make distributions more than 50 years after the bill's enactment would lose their GST exemption. Under that reform, perpetual trusts would be subject to a 40 percent tax on all trust assets whenever the last member of a given generation of beneficiaries dies.

These all-at-once reforms share many of the traditional problems of an estate tax. They do not typically coincide with sale of the trust's assets, making valuation difficult for the government. For liquidity-constrained trusts, the tax event may cause the sale of assets the trustee would otherwise prefer to retain. Reforming the estate and GST systems to include retrospective taxation would help address those problems, but most of the revenue from a reform such as the Warren bill would be many years outside of the traditional 10-year budget window. This also presents the risk that heirs would lobby to repeal the reform before the tax event can occur, or plan to dodge the rare taxing event. In Canada, for example, tactics to avoid the every-21-year tax are so well known that they appear in standard legal texts describing the tax.

Thus, as with the proposals for taxing gifts and bequests for individuals, Congress should use the constitutional flexibility it has available when taxing trusts to smooth

tax revenue over the period before an asset is sold. Like in the case of the estate tax, the Supreme Court has said there is little constitutional problem in taxing legal entities such as corporations and trusts, whether or not the entity has "realized" gains.[88] Even if trusts were not a loophole that desperately needed closing, imposing annual tax on them would be an appealing option because it would give Congress the opportunity to accelerate some of the revenues from a FAST reform. Annual taxation would also make elaborate planning techniques, such as the Canadian combination of "roll-outs" to shift income from a trust just before its 21st birthday, considerably less effective.

While arguably simpler than patchwork alternatives, an effective withholding tax still has a number of technical details, as set out in Galle, Gamage, and Lord (2025). One detail important enough to receive some mention is the exemption threshold. Obviously, it would not be desirable or politically feasible to impose the withholding tax on small trusts, such as those middle-income earners use to avoid judicial proceedings when bequeathing the family home to their children. The point of the withholding tax is to close up gaps in the estate tax system, and so its scope should be limited to families whose wealth would likely exceed the estate tax exemption amount. The difficulty is that the marginal cost of setting up and administering parallel trusts with identical terms and trustees is small. Therefore if the exemption amount is per trust, as in the BIT proposal from Sen. Wyden, taxpayers can easily create dozens or hundreds of trusts to multiply the exemption amount as needed.

A more effective approach might be to assign exemption amounts to families, not trusts. Individuals would be able to transfer all or a portion of their lifetime inheritance tax exclusion of $15 million to any trusts in which they hold an interest as beneficiary. As an anti-abuse rule to prevent planners from using straw beneficiaries to inflate the exemption amount, a trust would only have the smallest exemption amount of the exemptions assigned to it by its various beneficiaries. Galle, Gamage, and Lord (2025) describe rules to foil other efforts to manipulate the exemption amount.

Example 9.6: Exemption Assignment for a Trust Tax

The Straw family has established a trust, T, to hold stock of the family business. The trust has three real beneficiaries, daughter Bendy, son Last, and granddaughter Polly. It also attempts to add a token beneficiary, cousin Mann, who receives one share of stock. The exemption amount available to each

[88] More technically, recall that the 16th Amendment relieves Congress of the obligation to apportion "direct" taxes by state population. The *Moore* case leaves open whether the term "income" in the 16th Amendment includes unrealized gains. Even prior to the 16th Amendment, the Court held that a tax on the privilege of doing business through a legal entity is not a "direct" tax that would have to be apportioned. Thus, whether the 16th Amendment's definition of "income" requires realization is not relevant to trust taxation.

beneficiary is $15 million. Each of the real beneficiaries also has a personal trust used for asset protection, and they assign $5 million of their exemption amount to their respective personal trusts. Therefore Bendy, Last, and Polly each assign an exemption amount of $10 million to T. Cousin Mann assigns a full $15 million exemption to T. Because T's exemption amount is the lowest exemption of those assigned by all its (living) beneficiaries, T is only exempt on the first $10 million of its assets.

Concluding Thoughts

Retrospective techniques can be used to address both the weaknesses of a traditional estate tax as well as the holes in capital gains taxation under the income tax. In the integrated FAST system, sales of inherited assets result in capital gains tax as well as an additional inheritance tax charge, and these results hold whether or not assets are held in trust.

Chapter Ten: Details and Technical Analysis

• Wealth and MtM taxes are relatively similar when implemented through a retrospective method such as the FAST. An MtM-style FAST would bring in revenue more quickly, however, and for that reason I favor it as the baseline proposal.

• The FAST uses a lifetime $15 million exemption amount, modeled on the Canadian system, rather than taxing individuals based on their net worth. This lifetime approach faces fewer constitutional challenges and is easier to implement when tax is imposed retrospectively.

• To encourage prepayments and mitigate the possibility of large selloffs of assets before the law goes into effect, the FAST has a transition rule in which prepayments during the first two years after enactment are not subject to any interest charge, and payments can be spread over the next seven years.

• As an anti-abuse rule, dividends and similar payments to related parties are treated as though made to the taxpayer themselves.

• The FAST interest calculations give investors the benefit of full annual deductibility of all losses, but to deter abusive tax shelters taxpayers still face standard income tax limits on loss deductions in the year of an actual sale or prepayment election.

This chapter delves into a series of detailed questions about how we should draft and implement the FAST. I aim to offer some initial thoughts on the series of design choices drafters and regulators would need to consider. The goal here is also transparency into the difficulty of making major changes to any tax system. As Kleinbard (2016) trenchantly observed, many tax policy reform proposals are formulated at a sufficiently high level of generality so as to make it hard to assess whether those proposals can really be drafted and implemented. My aim is to at least clear the Kleinbard hurdle so that the reader has a realistic sense of whether the FAST could actually be made into operable law.

Wealth or MtM Model?

An initial choice drafters must make, and one which will determine a number of other details, is whether to model the FAST on a wealth tax or instead on an MtM income tax. The FAST can be designed to recreate the revenues and economic incentives of an

annual tax system of either form. For example, the FAST could mimic a 2 percent annual wealth tax by awarding the government an incremental 2 percent share of household assets, to be collected at sale (or, technically, a slightly less than 2 percent increment each additional year; see Galle, Gamage, and Shanske 2023 and Morgan 2025 for more detail). Alternatively, the FAST could mimic an MtM tax by awarding the government a tentative share for purposes of taxing dividends, and calculating the exact retrospective tax using a formula that measures the tax needed to reduce the sold asset's pre-tax return to its after-tax return. The two options differ along four major dimensions.

Precision-Complexity Trade-Offs

First (and second), the wealth and MtM models offer different resting points in the familiar tax policy balance between precision and complexity. A wealth-model tax does not depend on how well or poorly a taxpayer's investments have performed, but instead just taxes their value at a particular moment in time. Suppose Effie and Elsie each own $100 million in stock of their private companies, F and S, respectively. In a given year, F might rise to $110 million and S might rise to $101 million. Effie and Elsie will owe very similar amounts of wealth tax, notwithstanding the fact that Effie had 10 times as much annual income.

It may seem strange to impose an annual tax without considering the exact amount a given taxpayer's investments earned, but we can think of the wealth tax approach as a form of tax simplification. Although it doesn't measure the performance of the exact assets that a taxpayer owns, a well-designed wealth tax is effectively taxing each household as if their assets performed at the average of all assets held by others with similar wealth (Morgan 2022, 2023). For example, a 2 percent wealth tax would impose the same amount of tax as a 20 percent tax on a 10 percent investment return. We might think of the wealth tax as just a way to impose income tax under an assumption that everyone earned the average return. The wealth tax approach thus greatly simplifies tax rules and reporting (in particular, those relating to computation of basis), at the cost of some slippage in how precisely the tax is calibrated to a household's annual changes in ability to pay. Households whose assets vastly outperform others will be more lightly taxed, and vice-versa.

To assess this trade-off, we need to get a clearer sense of what we are losing in precision, but gaining in simplicity, with a wealth tax model. Let's start with precision. For the most part, I've argued that we should tax the ultrarich both because of their higher ability to pay and because of the unique private value and social cost of massive wealth accumulation. On this second front, the differences between wealth and MtM models don't seem very important at all, as both are ways of measuring the consumption value and negative externalities of growing wealth. Perhaps as a political matter it is easier to tax wealth as it is accumulating, as an MtM tax does, rather than aiming at wealth that is already accumulated, as in a wealth tax.

The sharper gradient is on the measure of ability to pay, or at least its annual changes. An annual wealth tax can sometimes impose what look like astronomical effective tax rates on income (Morgan 2023). But it's unclear whether that should matter in any policy evaluation. Arguably, the important measure of a tax's precision is whether it tracks ability to pay over the time horizon households use for their own planning, such as their lifetime (Shaviro 2007). Over a long period, what looks like a volatile effective rate under a wealth model may well average out to be indistinguishable from what the MtM model imposes. Still, households and voters may have reasons to respond strongly to annual measures of effective rates, such as if that is the only way they can readily observe tax burdens and decide whether the burden fits their distributive preferences (Galle and Utset 2010). Annual effective rates might matter for liquidity and salience purposes as well. Astronomical effective rates, in other words, can be a point of political vulnerability, even if not a key factor in an economist's scorecard.

A retrospective approach somewhat collapses these differences. As a household holds a given asset longer, its effective income tax rate under a wealth model will tend to converge toward the MtM model, as the asset's returns will typically converge toward the mean. That means both approaches in effect tax households who enjoy the benefits of holding wealth over long periods. A wealth model always presents the possibility, though, that a given taxpayer will encounter some extreme outlier result, and savvy opponents will ensure that it will be this unfortunate taxpayer who ends up giving congressional testimony against the bill. On the other hand, for very highly appreciated assets the retrospective formula for an MtM model can sometimes impose very high tax rates as well, although never in excess of 100 percent, making it uncertain where the best political optics lie.

On the complexity side, an MtM model is likely to be considerably more expensive to design and administer in the long run. Again, the key complication for an MtM model is that it is part of the income tax and so has to work alongside fundamental income tax concepts such as basis and depreciation. Rules for tracking and adjusting basis build up complexity exponentially as they encounter special situations such as partnerships, anti-abuse rules for income stripping (detailed more later in this chapter), and then the interactions of those kinds of settings. In addition to the costs of compliance and enforcement *per se*, complexities of these kinds tend to add to the likelihood of successful and economically distortive tax planning.

There is another hand, though, and in it are the higher startup costs of establishing a wealth-model regime. Authors of a wealth-model tax must decide to what extent existing income tax concepts should extend to the wealth-model design. Should the wealth-model tax import the hundreds of tax expenditures now in the Code? If so, how? To take a simple example, does the wealth-model tax exempt charities? If so, then the marginal value of transferring assets to a charity will rise relative to a world with no

wealth-model tax. Suppose we thought that incentives for charity holdings were already optimal (we don't—see Galle 2016—but let's just suppose). What further rule should we adjust to avoid over-incentivizing charitable ownership? In addition, many tax timing rules, such as the treatment of uncertain events, have different implications for an annual wealth tax than for an income tax. All these are translations that the drafter, and then lawyers, regulators, and other compliance actors, would have to learn and adapt to.

Timing Differences

Wealth models are slower to reflect a household's changing economic conditions than an MtM model, and this difference has several different implications. As asset values change, an MtM model immediately incorporates that change each year, while a wealth-model tax would reflect only a small fraction of the change. For instance, if Effie's stock loses $1 million in value and falls to $99 million, a 20 percent MtM tax would give her an immediate $1 million deduction worth $200,000 (subject to possible loss limitations) while a 2 percent annual wealth tax would simply reduce her tax burden by $20,000 per year. Again, this difference is muted in a retrospective system; if Effie waited 10 years to sell her stock, both systems would likely reduce her liability by $200,000 in that year as a result of the earlier $1 million drop (ignoring possible retrospective interest charges, and assuming that the stocks were highly appreciated before that year).

Because of their more inertial response to economic changes, wealth models are less apt to be affected by macroeconomic cycles of booms and busts, and that can have important implications for governments with balanced budgets or European-style "debt breaks." Galle, Gamage, and Shanske (2025) argue that US states have to budget with care if they adopt pure MtM models, because a deep local downturn could result in a sharp reduction in MtM tax revenue or even a spike in net refunds, which most state budgets are not designed to account for. Federal budgeting is less sensitive to these kinds of cycles but conceivably a downturn could trigger the debt ceiling.

This shouldn't be as much of a concern for the FAST, though. In the current income tax environment, realizations peak during recessions as taxpayers harvest losses, driving down government revenue. If that pattern persisted under an MtM model retrospective tax, then it, too, might be somewhat pro-cyclical, losing revenue during downturns. A wealth model would not be nearly as sensitive, since there would be little tax incentive to sell during bad times. But the FAST aims to mostly eliminate asset lock-in. If that effort succeeds, then taxpayers will not have a large store of losses waiting to be realized, and so there shouldn't be much correlation between economic conditions and realizations. The FAST's optional prepayment rules also would soften any pro-cyclical effects of the realization principle by allowing taxpayers with broad losses across their

portfolio to claim those losses without selling, thereby avoiding the downward price pressure that tax-loss harvesting usually creates.

While wealth models are less vulnerable to downturns, they also lag somewhat during periods of sustained growth or booms. That can mean that a wealth model offers greater political optionality, as families who benefit most from the boom period would be taxed immediately under an MtM model but face somewhat more delayed liability, which they might be able to work to avoid, under a wealth model. The wealth model would also not capture as much revenue within the traditional 10-year budget window. Both of these would remain broadly true under the FAST, assuming that realizations proceeded at about the same pace under either model.

Similarly, an MtM-model FAST would probably have a larger revenue score, although the exact extent would depend on transition rules I discuss more below. Again, revenue estimators would expect that more economic gains over the next decade would be taxed under an MtM model. More importantly, the MtM model could tax immediately as much as 100 percent of pre-enactment appreciation, though realistically the revenues from that would probably be spread out over a number of years. In my proposed transition rule, pre-enactment gains would likely be taxed in the first two years of enactment, with payment spread over the next seven. A wealth-model FAST would tax only a small share of existing wealth each year, and would not offer as strong incentives for households to recognize their gains immediately.

Timing differences also cause wealth and MtM models to diverge when households can move between jurisdictions. Again, realization lets taxpayers choose not just when but where to realize their gains, allowing them to shop for the lowest-tax place to sell. That is still somewhat true of a wealth-model tax: Since tax liability accumulates over time, households can save on future wealth tax by leaving a jurisdiction that imposes it, though wealth taxes do constrain many common tax-planning techniques wealthy Americans use today to dodge state and local tax (Galle, Gamage, and Shanske 2025). An MtM model further diminishes incentives to relocate, because the household will owe tax as soon as gains have accumulated. That makes it hard to get rich in one place and then flee to another.[89] These mobility effects are not of major importance at the US federal level, but their benefits for state income tax systems that copy the IRC might be a modest reason to prefer MtM models.[90]

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[89] MtM models still reduce moving incentives even under a retrospective system, as long as the taxing jurisdiction imposes a continuing obligation to pay accumulated tax liabilities after the taxpayer physically relocates. Galle, Gamage, and Shanske (2023, 2025) explain how states can constitutionally arrange for contracts in which taxpayers agree to continuing personal jurisdiction in exchange for relief from having to immediately pay the tax.

[90] Among other reasons that mobility effects are less important at the national level is the existence of a federal "exit tax," or deemed realization, for expatriating citizens. IRC § 877A. Commentators expect the exit tax to face challenges under *Moore* (Avi-Yonah 2025b). An exit tax is also somewhat disadvantageous for the taxing government, because it in effect gives the expatriating citizen an automatic tax "freeze" at

Marginal Incentives

The divergent rate structures of a wealth and MtM model tax also result in somewhat differing effects on investors' incentives. Many of these differences can be quite technical, and are explored in detail in, for example, Morgan (2023). Briefly, a wealth model probably has smaller effects on decisions about how to invest, but rather larger effects on decisions about spending. Wealth models are less apt to affect investment choices because they impose a lower marginal rate on investment profits, holding consumption choices constant (IFS 1978, 351). And they encourage consumption over continued savings because, unlike an MtM model, the tax rises the longer the owner waits to consume their wealth. This latter effect might be desirable if one of the reasons for adopting the tax is exactly to discourage massive and continuing wealth accumulation. The FAST narrows that preference for wealth models somewhat, as the longer a household holds an asset, the larger their FAST liability is likely to be under either model.

Summary

As drafted, the FAST adopts an MtM model, but a wealth model would certainly be entirely defensible. The MtM model brings in money faster, and that diminished room for political optionality is likely to be especially important for a reform that is probable to be as fiercely contested by wealthy interests as the FAST is. Although the MtM model makes it more challenging to write the core rules for the FAST to operate, it means that we don't have to make a series of dozens of policy judgments about how to integrate a wealth-model FAST with existing income tax choices. In a sense, the uncertainties about an MtM FAST are relatively known and familiar ones, such as questions about how to prevent income stripping (which I detail a bit later in this chapter), whereas it is hard to quite predict what the unexpected policy interactions and challenges would be for a wealth model. Finally, the MtM model is probably more helpful to states, although most would probably want to enact rainy day funds or other mechanisms for spreading out the up-front influx of revenue an MtM model would yield them (Galle and Stark 2012; Gamage 2010).

Structure of the Exemption Amount

a time and under conditions of their own choosing, much like the gift tax. The FAST would modify the exit tax to more closely resemble the FAST prepayment option. Expatriates would remain subject to FAST until their later sale of any expatriated assets. They would also have to agree to ongoing self- and third-party reporting, as if they were still taxpaying citizens. They would also have the choice of immediate taxation under a valuation regime controlled by the IRS.

The base FAST proposal exempts households on their first $15 million in lifetime gains (other than gains that are subject to mandatory FAST treatment, such as in the case of carried interest payments). In other words, for more than 99 percent of US taxpayers, there will be no change from current law. For example, until they net at least $15 million in profits, a family that sells investment property held more than one year will only pay tax at the long-term capital gains rate, with no FAST adjustment. The lifetime exemption is modeled on the Canadian system, which grants taxpayers a lifetime exemption from the first $100,000 in capital gains. Because household expenses are not meaningfully higher for married than for single individuals in this wealth range, the exemption amount is per household, not per individual.

The rationale for sharply limiting the applicable taxpayers is partly based on administrative burdens, and partly on the underlying goals of the reform. While the FAST is not particularly more difficult to calculate than the standard capital gains calculation, it does require a bit more recordkeeping. Taxpayers must be aware of which assets they have elected to prepay tax on. They must also know the government's effective share at the date of any dividend or other distribution from an asset subject to the FAST. For assets held through a broker or financial advisor, the current rule requiring brokers to track their investors' basis could be extended to include also noting these two additional data points. Though these added burdens are individually modest, they might add up when applied to the half or so of the US population with investment assets.

In addition, the key motivator of the reform is that it is primarily America's wealthiest investors who have benefitted most from their current option to delay or even permanently ignore tax on their profits, and who earn substantial imputed income from the power and influence their wealth commands. Data suggest that it is mostly the top 1 to 5 percentile of earners who have exploited the realization rules the most, with exploitation rising sharply at the very top (Agersnap and Zidar 2021; Fox and Liscow 2025). The BMIT focused more narrowly on centimillionaires, who are fewer than 0.1 percent of households. There isn't clear social science evidence on where in the income distribution it is that wealth begins to provide disproportionate social influence. It may be that wealth of between $30 and $100 million provides only somewhat more social control than for ordinary voters, but the incremental tax burden of the FAST in this range is modest during the taxpayer's lifetime.

This lower threshold is therefore necessarily somewhat arbitrarily chosen, but another reason to set the exemption amount at $15 million in lifetime gains is to align with the estate and gift tax. Integration with the estate and gift system is a key component of the FAST and the current exemption threshold for those taxes sits at $15 million per individual for 2026. On average, about 50 percent of the wealth held by the richest households is untaxed gain (Agersnap and Zidar 2021). A lifetime exemption amount of $15 million in realized gains would thus correspond to the $30 million estate tax

exemption amount, which is measured in gross assets. A cutoff at this level also puts those subject to the FAST well within the top 1 percent of US households—those with more than $13.6 million in net worth—who collectively own about 31 percent of US wealth.

Of course, where exactly to draw the exemption line probably depends on pragmatic political considerations as well. Many families with wealth between $10 and $100 million will likely assume they will be subject to the FAST even if they are not, so the government may as well collect revenue from those who will (mistakenly) oppose it even if the threshold were too high to realistically affect them. Probably the labeling of the "billionaires minimum income tax" was meant to convey to low-information voters that the tax had no chance of reaching them, but it is likely that accurately attaching a "mega-millionaires" label—"Mega-Millionaires FAST"—would accomplish the same goal.

Lifetime Exemption or Net Worth Threshold?

The lifetime exemption amount differs from previous proposals, such as the BMIT and the BIT, which instead generally exempt households with net worth under $100 million (the BIT also had an alternative threshold defined by income). Setting aside the exact exemption amount, the key difference between the two approaches is that the BMIT approach, which I'll call "annual exemption," imposes FAST liability on every dollar of gain for every household with net worth above the threshold, and zero FAST liability for any household under it (setting aside a possible rate phase-in). In contrast, the lifetime exemption amount would impose no FAST liability (but still standard capital gains or ordinary income) on the first $15 million in gains, even for billionaires.

Lifetime exemption might lose or delay some revenue, relative to an annual exemption. Centimillionaires and billionaires will get a tax benefit from the lifetime exemption that they would not receive from an annual exemption approach, though because there are not that many of these households, the benefit is relatively small in budget terms. And while those households will likely easily exceed the FAST lifetime exemption amount, they might not do so in their first few transactions after enactment, which could potentially push some revenue out of the 10-year budget window. The transition rule allowing optional prepayment of gains that were built-in at enactment will mitigate that effect, as households will have strong incentives to realize their enactment date built-in gains immediately, pushing them above the threshold. Still, if these revenue effects were serious concerns, the lifetime exemption amount could be adjusted downwards.

Despite the possible revenue loss, lifetime exemption is appealing in part because it mitigates the risk that an annual exemption approach might be unconstitutional. Critics of the BMIT suggested that, because it imposed a greater tax on households with net worth in excess of $100 million than those below, it was in effect an unconstitutional tax on wealth. That critique is sharpened further to the extent that the annual

threshold includes a phase-in range, so that for some taxpayers each dollar of additional wealth would increase their annual tax bill. Defenders might plausibly argue in response that the annual exemption is not taxing wealth, but instead is taxing realized gains, with a tax *rate* on those gains determined in part by reference to other features of the household (see Glogower 2018). But that argument has not been tested recently in court.

At a minimum, then, any bill would likely need to include the lifetime exemption approach as a fallback option. That is, if drafters strongly preferred annual exemption, they might use that as the base version of the bill. The bill would provide, however, that if a court finds that the annual exemption approach is unconstitutional, the lifetime exemption approach will go into effect instead. My understanding is that the JCT would typically score such a bill on the assumption that the baseline version would be upheld.

Still, in my view, lifetime exemption should be the baseline approach, even if its revenue score is a bit lower, because life exemption is much simpler. While annual exemption is fairly straightforward for an annual tax such as a wealth tax or the BMIT, it doesn't fit well with a mostly retrospective tax such as the FAST. For example, it would be challenging to design a FAST with an annual exemption to avoid large cliffs at the exemption threshold. A lifetime exemption amount comes with a built-in phase-in: The household that realizes $15.1 million pays FAST only on $100,000 in gains. The BMIT was drafted to phase in beginning at $100 million in net worth, with the amount of added tax imposed each year gradually increasing as the taxpayer's net worth rose.[91]

It's unclear how to draft an annual exemption phase-in for a tax that is mostly retrospective, as in any given year in which the household is above the threshold they might have zero or only a small amount of realized gains. Perhaps FAST liability could be reduced by some percentage for households close to the threshold in the year of realization. That, though, would encourage strategic timing of sales and make it somewhat important to estimate net worth fairly accurately. Again, one of the points of a retrospective tax is to avoid having to make precise measures of net worth every year.

Things are messier still if the annual exemption has to be based on unrealized gains rather than net worth, as the Constitution may require. A household's net unrealized gain will rise or fall as it sells assets, potentially moving the household under or over the threshold over the course of the year. To mitigate uncertainty, the threshold could be defined as unrealized gain at the end of the prior tax year, though this could lead to some perceived unfairness in situations in which assets decline sharply. Either way, households would also have significant gaming opportunities, such as by strategically

[91] As drafted, taxpayers who opted for deferral under the BMIT faced a higher tax rate if they were in the phase-in range, because the deferral option did not adjust the tax imposed to reflect the rate that would have applied during the original taxable year.

selling high-gain properties in years when the applicable tax rate will be low, or selling in order to move the household in or out of the threshold.

Lastly, the lifetime exemption approach probably eases reporting and information-collection burdens, which have at times been a tender spot opponents of wealth taxes have poked at. Meaningful enforcement of an annual threshold based on net worth or unrealized gain probably requires at least some amount of third-party reporting of the value of taxpayer assets (and liabilities, of course, in the case of a net worth measure). While some Nordic countries today have this kind of synoptic view into their citizens' financial lives, it would be new to many in the US. Recent legal challenges to and executive backsliding on beneficial-ownership reporting for business entities suggest that instituting a new reporting system might add a significant additional source of opposition for the bill.

Enforcing a lifetime exemption does probably call for some added information reporting, but it seems likely to be a lighter political lift. Of course, taxpayers are already legally obligated to report realization events, and many third parties, such as investment brokerages, must report sales by their clients. The added data point that would be helpful to IRS auditing efforts would be for each reported sale to disclose the taxpayer's remaining lifetime exemption amount, or at least the aggregate amount observed by each third-party reporter, as is now done for gifts. Taxpayers with relatively small aggregate lifetime sales to date, such as under $5 million, could be exempt.

Transition Rules

As I mentioned above, a potentially major difference between a wealth- and MtM-model FAST system is in how they treat untaxed gains that are already accumulated at the date the bill is enacted. A wealth-model FAST doesn't need any special transition rules for untaxed wealth that exists at the enactment date, as it just applies an initial government share of 2 percent (or whatever the chosen statutory rate is) to all existing assets. Algebraically, the 2 percent share will have the effect of collecting revenue as if the household owed a 2 percent wealth tax in the enactment year, and then were charged interest at the internal rate of return of their respective assets between that year and when the assets are ultimately sold.

In contrast, an MtM-model FAST designer has to make decisions about what to do with built-in gains at enactment date. In the absence of any special rule, the mathematical formula for computing retrospective FAST liability uses the difference between an asset's sale price and its original basis to calculate the asset's internal rate of return. The calculation of the interest charge, somewhat counterintuitively, ignores the amount of time the owner has held the asset; all that matters is the relative increase in

value over the original purchase price. This will be the same relative increase that is applied to the tax due.

I've generally tried to spare the reader from encountering much math, but the specifics of this formula matter a great deal because absent a transition rule it will have the effect of imposing interest on pre-enactment gains. That is, the formula computes the internal return on an asset over its entire time in the seller's hands. A seller who sold a highly-appreciated asset one day after enactment would be charged the same interest as someone for whom that same value accumulated fully after enactment.

While that result is at least somewhat defensible, it probably creates unnecessary political vulnerabilities for the bill. On the defense side, taxing pre-enactment gains is economically highly efficient (Auerbach 2006). Further, as I've argued, the FAST can be thought of as, in part, a tax on the luxury of being able to invest and earn high returns over long periods. Right now, our tax system is incorrectly failing to tax this opportunity, so that investors perhaps cannot complain of their good tax fortune (Kaplow 1986). But complain they certainly would. Opponents might argue, for instance, that households that recently diversified their portfolios would face much lower initial tax liability than those whose wealth remains mostly in the family business. And charging the equivalent of interest on pre-enactment gains has at least a strong resemblance to a retroactive tax, which some survey respondents have said they dislike.

Another risk is that without a transition rule the bill might trigger a large sell-off of existing investments. Taxpayers with highly appreciated investments who sell before the legislation's effective date would only have to pay tax at capital gains rates, while those who sell after would face the extra FAST interest charge in addition. In the past, tax legislation has sometimes imposed higher rates retroactively on transactions that occur before enactment, but there are both practical and legal limits that might still leave room for sell-offs.

Although there are a number of potential transition rules that would mitigate the pre-enactment interest issue, it turns out that the cleanest option with the fewest trade-offs is a twist on the prepayment option already built into the bill. Recall that the FAST allows any taxpayer to opt to settle their existing tax liability at any time. That option could be expanded to resolve the transition issue by allowing electing taxpayers to pay only the standard tax rate, without the additional FAST interest charge, if they make the election within two years of the bill's effective date. Because this initial taxable amount could be large, payments could be spread out over the next seven years (to keep all the delayed payments within the 10-year budget window).

The elective transition rule is helpful on several fronts. It eliminates any incentive for a pre-enactment sell-off, since it would give households a better tax result (partial deferral for up to seven years) than they could get from sale. It causes most existing

pre-enactment gains to be realized within the budget window, on the order of about $1 trillion to $3 trillion (Batchelder 2020; Leiserson 2020). Though many households will use their lifetime exemption to offset the elective tax, that means that further sales they engage in within the budget window are more likely to be taxable, an additional acceleration of revenue into the 10-year period.

Another key benefit is that the procedure for elective prepayments allows the government to appraise assets on more legally advantageous terms than would be available under other transition options. For example, Congress could simply provide that the FAST taxes only post-enactment gains—in effect substituting the value of an asset on the statute's effective date for its purchase price when computing the retrospective formula. But that avenue would of course require the IRS to dispute with taxpayers their assets' value at the effective date. As we have seen repeatedly, taxpayers generally win those contests, and that would likely be even more true in a situation in which IRS resources have to be deployed to appraise every nonpublic asset held by the wealthy. As I describe in Chapter Seven, the prepayment valuation regime instead determines the value of many assets by formula, and otherwise obliges courts to defer heavily to the IRS appraisal, unless the taxpayer opts out of prepayment.

Anti-abuse Rules for Uncompensated Transfers

Income shifting and stripping are time-honored tax minimization games—older, and probably more entertaining, than *Monopoly* (Kamin et al. 2019). These are tactics in which a taxpayer moves the legal rights to receive income to someone else with a lower tax rate. That's a bad move if the "someone else" is unrelated—you shouldn't pay $1 to save $0.37—but works well if the "someone else" is a child, spouse, or business entity controlled by the taxpayer. A classic example is a parent who buys bonds, then gifts those bonds to their young child, in the hopes that the interest payments will be taxed at the child's lower marginal rate. More sophisticated instances, at least in terms of the paperwork involved, include the efforts by multinational entities to transfer patent rights to an Irish subsidiary, then pay deductible royalties from the US parent to the sub. The US parent ends up with zero net income, and (before 2017) the Irish subsidiary's profits did not result in any US corporate tax.

In short, any tax system with an exemption threshold needs rules to block these games, and the FAST is no exception. Without any special rule, a wealthy taxpayer who has used up their lifetime $15 million exemption might gift a highly appreciated asset to a sibling who has not. That sibling could sell, then hand back the proceeds, perhaps minus a small facilitation fee.

There are three basic anti-abuse paths to choose from. The bill could treat every uncompensated transfer as itself a realization event, departing from the current practice of ignoring gifts. Alternatively, it might hold the transaction open until the

transferred assets are later sold, calculate the FAST charges as if no transfer had happened, and then assign the resulting tax bill either to the donor (the second path) or the donee (the third). For ease of administration, small gifts (say, those under the current annual gift exclusion of about $19,000) could be ignored. To be clear, what I mean when I say "as if no transfer had happened" is that the applicable tax rate and exemption amount would be the donor's, not the donee's. That is what distinguishes the third path from the current US treatment of gifts, which allocates the donor's basis (and thus untaxed gains) to the donee, but allows any gains to be reported at the donee's tax rate, including zero in the case of tax-exempt recipients such as charities.

There are some good arguments for taxing transfers immediately. In general, because of political optionality concerns and budget math, it's desirable to bring in revenue as soon as legally permissible. The Supreme Court has already said that a tax on gratuitous transfers is an indirect excise, not a direct tax that would need the 16th Amendment to escape the apportionment requirement. Gifts would thus be a permissible, and therefore potentially desirable, opportunity to accelerate payment of a retrospective tax.

On the other side of the fence, as explored in Chapter Six, are the familiar problems of valuation and liquidity when property is not transferred by sale. Mandatory tax at a time that might force the sale of heirloom family property is wildly unpopular. Valuation is so malleable in the current transfer tax regime that taxpayers use the occasion of the gift tax essentially as a tax avoidance strategy. That valuation procedure could be reformed, but the Due Process Clause somewhat constrains what is permissible in situations where the taxpayer has no choice but to accept the reformed procedure.

Therefore, in my view, the best compromise is to encourage but not require payment of tax at the time of a gratuitous transfer. The Due Process Clause permits stronger pro-government valuation rules if taxpayers have the option to reject those rules under terms that are not so punitive as to remove meaningful choice. An option to pay later, with an economically-accurate interest charge, is not punitive. If experience shows that taxpayers are not electing the prepayment option often enough, the tax rate on prepayments could be adjusted slightly downwards.

This rationale also tells us that we should prefer the second path in which liability stays with the donor, not the third path in which it moves to the donee. While gift-givers typically care at least somewhat for the welfare of gift recipients, data suggest that on average they weigh their own outcomes more heavily (Kopczuk 2013). Letting givers shift tax responsibility to gift recipients would therefore diminish their incentive to elect prepayment. Recipients might also make the election, of course, and would be fully incentivized to do so, but on average we should expect gift-givers to be more apt to have the cash on hand to pay the tax immediately.

The second path also has a useful fiscal federalism payoff. Many states mirror their tax codes to the federal system. Galle, Gamage, and Shanske (2025) explain how wealthy individuals in high-tax states often use gratuitous transfers to relatives or trusts in low-tax states to avoid state tax liability. A rule in which givers retain ongoing tax liability, or are incentivized to pay tax at the time of the transfer, would help defeat that common technique.

It might be argued that after a transfer the transferor may no longer have the funds to satisfy tax liability, but that is a problem that wealthy donors can generally solve on their own through contract. For example, a giver might require the recipient to agree to reimburse the giver for the tax, paid out of the sale proceeds of the asset.[92] If we were very concerned about donors who might make themselves judgment-proof through gifts to relatives (a concern already somewhat addressed by fraudulent conveyance rules in the Bankruptcy Code), we could provide that donees have secondary liability for the tax in the event that the donor cannot pay.

Judges have already crafted a similar rule in the case of certain donations of appreciated property to charity where the donor was planning imminently to sell the asset. In those instances, tax liability is assigned to the donor, rather than being erased by the charity's tax exemption. For charitable donors who require the charity to reimburse their subsequent tax bill, a special rule would help to resolve the question of what the donor's deduction amount should be in the event of such a contract. Current law already reduces the deduction if a donee takes on the donor's tax liabilities, but here that liability amount would be uncertain at the time of the donation. In the presence of such an agreement, then, a donor's deduction would be delayed until the charity sold the asset, and the amount of the deduction would be the net proceeds the charity realizes after the reimbursement. Again, this has a small precedent in current law, as it resembles the present treatment of donated automobiles.

Obviously, the second path isn't a live option for bequests. Inherited property therefore follows the third path in which heirs accede to the FAST status of the transferor—essentially carryover basis plus interest. Under previous efforts to implement carryover basis, estate executors sometimes complained that it was difficult for them to decide how to balance the distribution of the gross estate with the resulting tax liability for heirs, where some assets of equal gross value might have high basis and others low (Zelenak 1993). To somewhat simplify that choice, the FAST permits an executor to elect prepayment for all FAST liability, and to pay the resulting liability out of the estate before distributing the net proceeds to heirs.

[92] Courts might treat a gift subject to a tax reimbursement as at least a partial sale of the gifted asset. To facilitate reimbursed transfers, the FAST would provide that such reimbursement agreements do not result in a sale or other disposition of the transferred property. Again, if the parties actually want immediate realization they can opt for prepayment.

Interim Payments

The gratuitous transfer rules described above may help block income shifting, but may not be fully effective to prevent income stripping payments that do not take the form of an outright transfer of an asset. Again, a common example in the corporate context would be interest, rent, or royalty payments to a related entity. Individuals who own a small business might similarly use compensation to family members to reduce the cash holdings of the enterprise, and therefore its sale value.

Although the FAST will ultimately tax the value of commonly held entities wherever it might be shifted, there are several reasons to limit the ease with which taxpayers can move value around. If assets are taxed at differing rates, as would be the case if there is an extra 40 percent bracket for inherited property, then taxpayers will have incentives to strip value from the highly taxed asset to their lower-taxed portfolio. Shifting can affect the internal rate of return on assets (Gergen 1993). Additionally, if profits can be shifted seamlessly between entities, then limits on loss deductibility and the interest rate paid on them become less meaningful, as taxpayers can move taxable income from a profitable entity into the loss company to soak up excess loss deductions. And income stripping could have the effect of allowing families to multiply the lifetime exemption amount by making payments to family members who are still under their exemption threshold.

Example 10.1: Income Stripping 101

Lincoln St. Rip owns two sole proprietorships, OldCo and GrowthCo. OldCo is worth $10 million and St. Rip's basis in it is also $10 million. GrowthCo is worth $2 million and St. Rip's basis is $1 million. The tax rate on capital gains is 20 percent.

Scenario One: No Income Stripping

St. Rip sells OldCo for $10 million and GrowthCo for $2 million, resulting in $1 million in gains and $200,000 in tax due. Because of the high IRR on GrowthCo, the retrospective formula for additional FAST tax results in an added tax of another $59,000.[93]

Scenario Two: Income Stripping

[93] $2 million × (1 − ($2 million/$1 million)$^{-0.2}$) = $259,000.

St. Rip causes GrowthCo to make $1 million in royalty payments to OldCo, then sells OldCo for $11 million and GrowthCo for $1 million. St. Rip again has $1 million in gains, but this time from the sale of OldCo. OldCo's IRR is now 10 percent. Thus, St. Rip's additional FAST liability is only $8,000.[94]

The FAST addresses these kinds of payments by treating all but *de minimis* payments to the taxpayer's related parties as if they were dividend payments to the taxpayer. Recall that Chapters One and Eight explain that the FAST in turn makes all dividends the equivalent of a partial sale of the dividend-paying entity, in which the government collects a tax equal to its ownership stake times the amount of the payment (if that results in tax greater than the income tax that would be due if the payment were taxable as a dividend).[95] Later, at sale, the retrospective true-up formula includes these interim payments as part of the calculation of the asset's internal rate of return, but also credits the taxpayer for the amount of the earlier payments, and in effect also credits the taxpayer with interest at the computed IRR.

The anti-stripping rule extends this treatment to all payments to the taxpayer's related parties. If the taxpayer's business pays royalties to another entity the taxpayer owns, or salary to the taxpayer's children, those are also potentially treated as dividends *for the taxpayer* under the FAST. The taxpayer will have additional FAST income to the extent that the government share, times the amount of the payment, exceeds the amount of tax included for any payee, less any deductions for payor or payee. That is, if entity A pays entity B a royalty, and takes a deduction in the amount of that royalty, entity A's owner will have FAST income in the amount of the royalty payment. To preserve the single layer of tax for pass-through entities, payments to human payees by a pass-through entity ignore the offset for deductions.[96] For administrative ease, taxpayers can ignore up to $100,000 in payments to any particular third-party payee annually, and up to $500,000 in annual aggregate for all third-party payees. The rule thus ignores, for example, children working as summer interns at the family business.

When final liability is settled retrospectively, these payments are all treated as if they were in essence a dividend to the owner, followed by a contribution to the capital of the

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[94] $11 million × (1 − ($11 million/$10 million)$^{-0.2}$) = $208,000.

[95] To repeat, the deemed government share is an estimate of the applicable tax times the average untaxed appreciation in unsold assets. Since the latter share is generally around 50 percent, and the current applicable tax rate is 23.8 percent, the deemed share begins at 11.9 percent. It then rises each year by 1 percent of the remaining non-governmental share, where 1 percent is about 23.8 percent of an assumed average annual return of 5 percent.

[96] That is, if an S Corp pays out 100 percent of its gross receipts to its owner as salary, there will be no incremental FAST liability at the time of payment. The salary is still included as part of the sale price at the time of a later sale of the S Corp stock, with credit for tax paid on the salary as if it had been taxed at dividend rates.

related payee. Thus, when the ultimate sale price and IRR are calculated retrospectively, the payments to related parties are included as part of the sale price of the payor entity. The taxpayer gets a credit for any taxes paid by any party as result of the payments (but not in excess of the amount of tax that would have been paid if that payment were a dividend).[97] In the event of the sale of a payee entity, the basis of that entity is increased by the amount of the payment. In effect, these steps tax the profits that were moved around between related entities as part of the return on investment of the payor entity, not the payee.

Example 10.2: Income Stripping with FAST Anti-abuse Rules

Lincoln St. Rip owns two sole proprietorships, OldCo and GrowthCo. OldCo is worth $10 million and St. Rip's basis in it is also $10 million. GrowthCo is worth $2 million and St. Rip's basis is $1 million. The tax rate on capital gains is 20 percent. The government share of both assets is 10 percent.

St. Rip causes GrowthCo to make $1 million in royalty payments to OldCo, then sells OldCo for $11 million and GrowthCo for $1 million. St. Rip again has $1 million in gains, but this time from the sale of OldCo.

Results Without Anti-stripping Rule

OldCo's IRR is now 10 percent. Thus, St. Rip's additional FAST liability is $8,000, for a total of $208,000.

Results with Anti-stripping Rule

When GrowthCo pays OldCo $1 million, that is a potential dividend for St. Rip under the FAST because it is a payment to an entity that he owns. St. Rip will have FAST liability of 10 percent (the government share) times the amount of the deemed dividend. The deemed dividend amount is the amount of the payment to the related party, minus the net tax liability arising from the transaction. In this case, assuming that OldCo and GrowthCo are both pass-through entities that file separately from one another, the payment results in $1 million in income for OldCo, as well as a $1 million deduction for GrowthCo. Since this is a net tax liability of $1 million - $1 million = $0, St. Rip gets no credit for paying tax on the

[97] More exactly, the credit amount is the amount of distributions times one minus the applicable tax rate for sales of that asset.

distribution, and so the deemed dividend amount remains $1 million.[98] St. Rip will owe 10 percent × $1 million = $100,000 in tax.

Later, when St. Rip subsequently sells GrowthCo, the sale price for FAST purposes will be the $1 million sale price plus the $1 million in prior dividend payments, for a gain of $1 million. The IRR of GrowthCo will be computed as 100 percent, for a total tax of $259,000. St. Rip will receive credit, however, for the $100,000 earlier tax payment on GrowthCo's deemed dividend, yielding a net additional tax at sale of $159,000. OldCo's basis increases to $11 million as a result of the deemed dividend and capital contribution, resulting in $0 gain at sale.

Observation: The results with the anti-stripping rule in place match the results of Scenario 1: No Income Stripping in Example 10.1.

Tax Expenditures: Depreciation, Expensing, and Installment Sales

The retrospective FAST formula leaves taxpayers with the after-tax return that their investments would have yielded, ignoring any special preferences for certain classes of assets. In other words, assets that today benefit from expensing or accelerated depreciation would be subject to additional tax at sale, in effect clawing back the time-value of money benefits those provisions currently provide. After some efforts at designing modified rules to prevent this effect, both Land and I have concluded there is no ready formula that avoids both great complexity and taxpayer games. Accelerated depreciation and expensing are bad policies as currently implemented because they are opaque, complex, distort investment choices, and, depending on the extent to which tax benefits are capitalized into prices, may increase the cost of subsidized products for taxpayers below the top rate bracket.[99] A rapid transition away from these subsidies might, though, have unwanted price effects on the most affected industries. As a compromise and transitional policy, the FAST might be accompanied by tax credits that offset the incremental FAST tax for depreciable property, claimable in the year of FAST liability.

[98] The special rule for deductions claimed by pass-through entities does not apply here, because that rule comes into effect only for payments to humans.
[99] Any advocates who favor accelerated depreciation should be made to teach partnership rules for allocating gains from the sale of depreciation-recapture assets.

Deductibility of Losses

The FAST as drafted sticks to existing rules for tax losses, but has the economic effect of allowing some losses to be deducted that current law does not. Modern income tax systems generally attempt to sharply restrict taxpayers' ability to claim losses in excess of income for any given year. That is, a taxpayer with realized losses in excess of realized gain cannot typically get a refund or claim a deduction against other income. Instead, the taxpayer usually must wait and use unclaimed losses against any subsequent gains. These limitations are usually seen as serving two main purposes. For one, they reduce (but certainly do not eliminate) the tax payoff to loss harvesting, or the practice of selling losers but retaining winners in a realization-based regime. In addition, they offer a speed bump to various tax shelter strategies for manufacturing paper losses. For instance, in the absence of Section 1256, taxpayers might use offsetting swap positions to generate essentially unlimited losses on December 31, to be recouped the next day.

Loss limitations are economically damaging, however, to the extent that they are unnecessary to closing off these tax avoidance opportunities. If failed businesses cannot claim loss deductions, then risky business ventures become even riskier, and less attractive (after tax) than safer bets. This is an economic cost worth paying if the alternative is endless and wasteful loss harvesting or tax shelter transactions, but likely not otherwise.

In principle, then, a broad-based MtM tax might allow for refundability of losses. Loss harvesting is irrelevant under an MtM system. Further, while the tax system is not often particularly nimble, tax shelters capable of regularly generating tax losses in excess of taxpayer income have generally been shut down pretty quickly.

The FAST therefore moves closer to full loss allowability, but does not fully get there. The FAST retrospective formula replicates the cash flows of an MtM tax with full deductibility of losses. Again, the goal of the retrospective formula is to make taxpayers indifferent about when they sell by leaving them with the after-tax return they would have earned over the life of the property. In the case of risky assets, this requires that the ex post payoff of an investment must still be the after-tax payoff, whether there are gains or losses. That is, the formula leaves the selling taxpayer with the same after-tax amount they would have held if they had paid tax on an MtM basis each year. With a 20 percent tax, for instance, the after-tax loss will be only 80 percent of the pre-tax loss. In effect the formula presumes that losses would have been fully deductible each year.

The exception arises in the year of realization or prepayment. Again, the FAST follows standard income tax rules, including rules for claiming losses, wash sales, and so on. Although the FAST formula might award a selling taxpayer a tax loss amount that reflects the cash flows of a fully deductible MtM tax, the taxpayer must still have

sufficient gains in the realization year to be able to claim that loss immediately. As under current law, careful planners will generally be able to claim a significant fraction of losses, but the cost to the Treasury of this planning will be lessened due to the more economically accurate treatment of gains.

Inflation Indexing

As drafted, the FAST would follow the same approach to inflation as the rest of the income tax system: Although exemption amounts and the like would be adjusted annually, the FAST would still include gains due to inflation in the tax base. It is very unlikely we will see political reforms to tax only real (net of inflation) gains for the tax system overall. Adjusting all gains for inflation would be very expensive in revenue terms and fairly regressive, unless it were accompanied by substantial marginal rate hikes for savers (Weisbach 1999).

There could be an argument for inflation-adjusting only assets subject to the FAST. As David Weisbach has explained, an MtM tax should generally exempt gains resulting only from inflation (1999). Taxing inflation gains can be seen as a form of rough justice in a realization-based system, under which the tax burden on inflationary gains serves as a penalty on holding assets. In other words, like the FAST, taxes on inflationary gains can be a kind of tax on the luxury of waiting. But unlike the FAST, inflation imposes a somewhat arbitrary and random tax, and one that can be mitigated with planning. That makes the FAST a much more efficient substitute. Adjusting tax burdens for inflation would also potentially affect monetary policy, as in theory a central bank that was optimizing interest rates would allow somewhat more inflation in a world where inflation caused fewer tax distortions (Galle and Listokin 2021).

A straightforward way of exempting inflationary gains is to adjust basis for inflation. In the FAST retrospective formula, basis appears twice, so inflating basis would result in tax that was too low. Instead, the formula could adjust the tax rate so that the amount of tax due is the amount that would yield the real after-tax return, when subtracted from the nominal pre-tax return.

But this approach would be complex, leading to some strange incentives in some cases, and might well strike many voters as unfair. Voters might object that very wealthy households are receiving relief from a burden that the voters still face. FAST-paying households would pay tax on nominal gains up until they reach the $15 million lifetime exemption, and not thereafter, potentially offering gaming opportunities with the timing of asset sales, gifts, and so on. And the share of assets in the economy that are subject to FAST is likely too small to meaningfully affect how the Fed sets interest rates. On balance, it seems better to keep the tax system to just one inflation rule.

Concluding Thoughts

I have argued that the FAST can resolve some of the legal, practical, and political obstacles to taxing the ultrarich. By taxing investment gains at sale but allowing optional prepayments, the FAST fits into the constitutional cubbyhole the Supreme Court demands, measures income at a time when reliable valuation data are available, and spreads tax burdens over time instead of imposing them all at death or another relatively illiquid moment for the payor. With these fixes, it's more likely that we can increase the real burden the tax system can place on massive wealth, and slow the growing accumulation of money and power among America's very richest dynasties.

In advocating for the FAST, I don't mean to suggest there aren't other valuable, even urgent, tax reforms. Although the FAST makes a good start at filling our deep revenue hole, many other spades are needed. To be sure, the FAST should have considerable revenue potential, especially in the 10-year period after enactment, as it collects revenue from all the ultra-wealthy's untaxed investment gains already in place at the date of enactment. Again, prior estimates on that front range from $1 to $3 trillion for similar policies, and since those estimates date from 2020 the figure is apt to be 25 percent or more higher today. Galle, Gamage, and Lord (2025) estimate that reforming trust taxation could raise another $1 trillion over 10 years. These are significant sums, but unlikely to meet the full cost of cleaning up the fiscal disaster left behind by the current administration.

There certainly are other reforms that would serve similar goals as the FAST while also raising additional funds. For instance, many of the very richest US billionaires hold a majority of their wealth in the form of publicly traded stock, per Forbes. Corporate taxes are certainly constitutional, fall at least in large part on investors, and once contributed a rather larger share of national revenue than they do today. The current administration has tried to undermine the historic effort at global cooperation in taxing multinationals, and has weakened key anti-abuse rules that limit multinational tax planning. Expensing and accelerated depreciation giveaways in TCJA and OBBBA have, under cover of mind-numbing accounting theorems, wiped out a large share of the business tax base. Reversing those decisions should be an obvious priority. While that reform would serve similar goals as the FAST in reducing the wealth and influence of large shareholders, it wouldn't necessarily pile tax burdens on top of what the FAST would impose. Since equity prices generally reflect the burden of the entity's tax, a reformed corporate tax would likely reduce FAST revenue for affected owners. The FAST complements that reform by ensuring that the tax system would reach ultra-wealthy individuals who do not own public equity, and enacting the two together would help provide a safeguard if one of them proves less effective than expected.

Similarly, although the FAST is mostly aimed at taxing investment income of the ultrarich, it can be complementary to other individual income tax reforms.

Well-designed efforts to close off popular loopholes—tax-minimizing partnership allocations or the absurd deductibility of private jets, say—might push tax planners to pivot more toward earning and minimizing the tax on investment (or "investment") income. The reverse is also true: If the FAST discourages tricks to reshape wages into "investments," then tax planners might find and exploit other income tax weak points. Patching both helps to make sure neither side of the tax balloon is leaking. As I've noted, the FAST also offers tools that can be repurposed to block many common tax minimization strategies, such as carried interest or installment sales, as Galle, Gamage, and Shanske (2023) explore in more depth.

While I've generally argued that the FAST is preferable to the alternative of further shifts toward exempting investment income, the FAST can even fit comfortably alongside a VAT. As Chapter Five explained, a VAT can worsen the problem of economic inequality, even if combined with cash rebates for low-income households. The VAT misses most of the wealth of the richest households, and actually favors the strategy of accumulating power over spending cash. A FAST counters these weak points, offering a new burst of both revenue and acronyms for the public.

In short, though the FAST is likely an essential component of meaningful tax reform, it probably shouldn't be the only one. But if all these reforms cannot be enacted together, FAST would at least be a major step toward a fairer and more fiscally balanced tax system.

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