Raising Revenue by Taxing Capital

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Mark Gergen, *A Securities Tax and the Problems of Taxing Global Capital* (June 2, 2020), available at SSRN.

The federal government's spending to try to contain the economic fallout from the COVID-19 pandemic already approaches $3 trillion. It will cause U.S. national debt to exceed GDP for the first time since World War II. The current crisis has emphasized deep distributive justice concerns and raised calls for more public spending to help address them. Such public spending is important and necessary, but there is a question of how to pay for it. Taxing wealth and capital income can be part of the solution. These are systematically undertaxed, even though careful analysis demonstrates that wealth taxation would not create an unacceptable drag on the economy.

Within the broad wealth and capital income tax literature, Mark Gergen's work offers a particularly clever and tidy approach to taxing capital. He proposes a securities tax to reach capital touched by the public market. This tax would be collected and remitted by market participants like public corporations. A complementary tax on imputed normal returns would reach private capital. Gergen recently posted *A Securities Tax and the Problems of Taxing Global Capital*, which describes international issues raised by his proposal. This paper follows on a 2016 article, How to Tax Capital, which covers the fundamentals of his idea.

Gergen's proposal would:

- Enact a "securities tax" on all assets touched by public markets – including publicly traded equity, publicly traded debt, and securitized assets such as mortgages, car loans, and student loans. It is estimated that this tax would apply to about 80 percent of the value of income-producing wealth in the U.S., excluding owner-occupied housing.
- Require remittance of the securities tax not by individual taxpayers, but rather by public market entities, like publicly traded corporations and mutual funds.
- Impose a complementary tax on imputed normal return from privately held assets.
- Allow rebates to individuals to accomplish preferences e.g., a lower tax burden on retirement or other preferred savings accounts. Consider allowing rebates of half the securities tax to nonprofit shareholders.
- Apply a low tax rate, such as 0.8%, which would raise an estimated $350 billion or more annually assuming the rebates listed above.
- Use a credit mechanism to avoid double-counting assets such as securities held through mutual funds.
- Minimize the incentive to invest privately because private-market disadvantages of illiquidity and higher fees would often exceed burden of tax at a low rate.
- Allow rebates to refund tax to foreign shareholders not subject to U.S. tax, assuming robust proof of beneficial ownership.

The most attractive part of Gergen's proposal is that that remittance by public corporations and other large public market participants would actually work. It is like the tax administration change that took place in the 1940s, which was the last time that national debt exceeded GDP. Then, the public finance

solution included the innovation of third-party reporting and withholding. The law enlisted employers to withhold and remit payroll and income taxes. This made possible the broad "Class Tax to Mass Tax" expansion of the personal income tax. In the 21st century, employer remittance results in 99% compliance for taxes on wages.

In contrast, other capital and wealth taxation proposals imagine rich individuals filling out tax returns and sending in large checks to the government. Expected compliance with such a system is low compared to wage withholding. Indeed, underreporting could be a fatal weakness for some wealth tax proposals. One paper suggests that a tax on the "ultra-wealthy" would resemble the estate tax and "approac[h] a voluntary tax."

Gergen's design attends to efficiency as well. Since the proposed securities tax is determined by reference to the value of outstanding securities, its incidence should fall directly on those securities and reduce their value directly. It would be a tax on capital in fact as well as in law. This contrasts with the perennial uncertainty over how much of the corporate income tax burdens capital as opposed to workers or consumers. Also, an innovative credit mechanism would ensure that publicly held capital is taxed just once. For instance, a public company would pay tax on the publicly traded equity and publicly traded debt issued by that company. If the company in turn owned public securities in another issuer, the company would receive a credit for the securities tax remitted by that issuer.

The proposed securities tax remitted by public market entities would not reach privately held assets, such as rent-producing real estate, interests in investment partnerships, and physical commodities. Gergen's solution to this problem is a tax on an imputed normal return to capital that is an element of a proposal developed by Edward Kleinbard. (We are mourning Ed now, after his passing on June 28.) As Gergen acknowledges, planning opportunities result from the difference between the imputed income tax on privately held capital versus the securities tax on publicly intermediated capital. But he argues that it is still better than a wealth tax that requires taxpayers to report asset values.

Gergen writes that his proposal raises concerns about the global taxation of multinational corporations. If the U.S. repealed its corporate income tax in connection with adopting the securities tax, then the change would encourage companies to shift taxable income and economic activity into the U.S. However, this distortion could be mitigated by continuing to impose corporate income tax on foreign multinationals' U.S. income.

A final issue is constitutionality. Although the Sixteenth Amendment permits taxation of income, the Constitution elsewhere requires the apportionment of "direct" taxes. Would Gergen's securities tax risk violating the requirement of apportionment? Gergen does not spill much ink on this issue. But the risk would be reduced if the structure avoided explicit connections between a corporation's obligation to remit securities tax and an individual's obligation to pay tax on wealth held through public markets. The Supreme Court has treated corporate taxes as excise taxes, not direct taxes. Congress might also enact "fallback" provisions that would apply in the event of a successful apportionment challenge.

Gergen's proposal for taxing capital is ambitious. It would be a big change and raises political economy and transition questions. But it is also a clever and above all administratively practical way to tax capital broadly and effectively. It should be on the table as we consider our pressing and increasing need for public revenue.

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