AMERICANS FOR TaxFairness

STOP PROTECTING BILLIONAIRES: CLOSE THE STEPPED-UP BASIS LOOPHOLE

TOPLINES

- **"Stepped-up basis" is a huge tax loophole for rich people** that allows them to avoid taxes on investment gains for their entire lives and pass those assets onto heirs who will never be taxed on that increase in value of the assets.
- President Biden would close this loophole that most benefits billionaires like Jeff Bezos and Elon Musk. Along with related reforms, this loophole closure **would raise $325 billion** to pay for public services vital to those who will not inherit massive investment gains.
- Stepped-up basis will allow the families of **billionaires who pay relatively little and sometimes nothing in taxes to dodge billions more in taxes.** Ending stepped-up basis eventually would prevent ultra-wealthy families from **dodging $1 trillion in taxes.**
- Stepped-up basis is an accounting fiction that makes millions or even billions of dollars in investment gains **simply disappear for tax purposes.**
- **Stepped-up basis helps create economic dynasties** because lucky descendants can inherit a fortune of investment gains and not pay a penny of tax on them.
- Under the Biden tax plan, **family farms and small businesses would not pay this tax** as long as they stay in the family.
- **Closing the stepped-up basis loophole is not a "second estate tax"** because it taxes income from investment gains, not accumulated wealth. Moreover, any capital-gains taxes paid would reduce the size of the estate being taxed.
- Except in the case of family farms and businesses, a weaker reform of stepped-up basis known as **"carryover basis" is not an acceptable alternative** because it would still allow rich families to indefinitely dodge millions or billions of dollars in taxes.

President Biden wants to close a gaping loophole known as "stepped-up basis" that allows billionaire dynasties and other ultra-rich families to escape paying income tax on a lifetime's worth of investment gains. If a billionaire such as Jeff Bezos or Elon Musk dies without selling their investments that have increased in value, those capital gains simply disappear for tax purposes. If whoever inherits the assets immediately sells them, no capital gains taxes are due. That is because according to a fiction in the tax rules the cost of each investment is no longer what the original owner paid for it, but rather its market value at the time of the owner's death—the stepped-up basis.

This loophole loses $44-$54 billion a year needed for vital public services and widens our nation's troubling income and wealth gaps. Devised when financial records were kept with pen and paper and the original cost of an asset could be lost between generations, stepped-up basis in an age of digitized and centralized data is nothing but a huge tax giveaway to the wealthy.

"Stepped-up basis" is a huge tax loophole for the rich that lets them dodge taxes on a lifetime of investment income.

- Increases in the value of assets like stocks and real estate—what are known as "capital gains"—are a kind of income, just like wages, rent, and bank interest. Capital gains are the difference between the amount you paid for the asset and how much you sold it for. If you bought a share of stock for $10 and five years later sell it for $30, you will owe capital gains tax on $20. (The top capital gains tax rate is just 20%, far below the 37% top tax rate on wages.)
- But if you died after five years without selling your stock and your descendant immediately sold it at the $30 price, they would owe zero capital gains tax. That is because this giant tax loophole allows your heirs to arbitrarily revalue the stock's cost at its $30 price on the day you died. That is, the stock's cost (also known as "basis") is raised —stepped up—from the original purchase price to its value on the day of inheritance.
- To repeat: capital gains are only taxed when the underlying asset is sold. If someone dies without selling, *those capital gains simply disappear for tax purposes*. Whoever inherits those assets is *never taxed* on the gains made prior to inheritance.
- A prime real-life example is Jeff Bezos, the nation's richest person thanks to the explosive growth of his Amazon stock, which he obtained for next to nothing as the company's founder. As recently reported by ProPublica, the income taxes paid by Bezos between 2014-18 represented less than 1% of his nearly *$100 billion income from capital gains* over that period. (His capital-gains income increased by another $84 billion over the first 13 months of the pandemic.) In two years, 2007 and 2011, he paid no federal income taxes. Under stepped-up basis rules, after Bezos dies those hundreds of billions of dollars—by then, perhaps well over $1 trillion—in lifetime *investment income* will go forever untaxed.

President Biden would close the stepped-up-basis loophole for billionaires and millionaires, which together with related reforms, will raise $325 billion for vital public services.

- Biden would close the stepped-up basis loophole so that wealthy families cannot avoid tax on a lifetime of investment gains. He would tax as yet untaxed capital gains of over $1 million ($1.25 million including the increased value of a primary residence) at the owner's death. For a married couple the first $2 million ($2.5 million including the increased value of a primary residence) would be tax-exempt. This would equalize the tax treatment of appreciated assets whether sold during the original owner's life or held till death.
- Because so few people die with that amount of untaxed capital gains, only 2%-3% of decedents would pay the tax, according to the Tax Policy Center. Remember: the tax is not on a person's total wealth, just the *growth in that wealth* that has not yet been taxed.
- Combined with two additional reforms that would eliminate other special privileges for how the rich are taxed on capital gains, the repeal of stepped-up basis for millionaires and billionaires would raise nearly $325 billion over 10 years.

- Biden's American Families Plan would use that revenue to raise working-family incomes, provide universal pre-K, make childcare and college more affordable for working families, and make other public investments vital to all of us who won't inherit millions of dollars in untaxed investment gains.

Stepped-up basis allows the families of billionaires who pay relatively little and sometimes nothing in taxes to dodge billions more in taxes. Ending stepped-up basis would eventually prevent billionaire families from dodging $1 trillion in taxes.

- According to economists Emmanuel Saez and Gabriel Zucman, of the $4.25 trillion of wealth currently held by U.S. billionaires, $2.7 trillion consists of untaxed capital gains. Those gains will completely escape taxation forever under current stepped-up-basis rules.
- Under the Biden plan, those gains would be taxed at the same top rate that applies to ordinary income: what Biden wants to raise in a separate reform to 39.6%. Ultimately, over $1 trillion in additional income tax revenue could be realized just from the nation's few hundred richest families, assuming the $2.7 trillion was taxed at the 39.6% rate proposed by Biden.

Family farms and businesses would not pay this capital gains tax on farm or business assets as long as the farm or business stays in the family.

- Under Biden's plan, family farmers and small-business owners will still be able to pass along their operations—no matter how much they've grown in value—to their children without any capital gains tax due on farm or business assets as long as the descendants continue to own and operate the farm or business. This means no farm or privately-owned business will ever need to be sold to pay tax on the capital gains of the farm or business. The only capital gains tax due from estates containing family farms or businesses will be from those with gains in excess of the exemption level on assets other than the farm or business.
- A lot of farmland is not owned by farmers: the biggest owner of U.S. farmland is Microsoft founder Bill Gates, who made his fortune from software, not sorghum. Politicians should stop using their supposed concern for real farmers to shield billionaires like Gates from paying their fair share of taxes.

Stepped-up basis is an *income-tax* loophole. Closing it will not create a "second estate tax" or an additional tax of any kind. It simply will equalize the income tax treatment of appreciated assets sold prior to death with those held until death.

- The income tax and the estate tax are different taxes. Income tax is paid annually on the income a person generates during life. All Americans with more than nominal incomes pay income tax. The estate tax applies to the total wealth a person passes to his inheritors, net of liabilities, at death. The estate tax only applies to the largest fortunes. Currently, fewer than 0.1% of estates (one in a thousand) is big enough to owe estate tax.
- Biden's elimination of stepped-up basis is a reform to the income tax, requiring taxation of capital-gains income received during a lifetime but gone untaxed because the underlying assets were not sold.
- The income tax paid on previously untaxed capital gains will reduce the wealth subject to estate tax for those few rich families that pay the estate tax, just as the income tax paid on

gains during the owner's lifetime reduces the size of the eventual estate. **Therefore, closing the stepped-up basis loophole will not result in double taxation because no estate tax will be paid on the wealth used to pay income tax on previously untaxed capital gains.**

- Capital gains tax under Biden's plan would only apply to unrealized gains in excess of $1 million per person and $2 million per couple ($1.25 million and $2.5 million, respectively, including the increased value of a primary residence), regardless of the size of the estate. Though very few, very rich families will owe capital gains taxes on previously untaxed gains, only a small fraction of that group will also owe the estate tax.
- Here is how the two taxes might apply to a great family fortune: If someone died owning assets worth $30 million for which they paid $20 million, their estate would owe capital gains taxes on that previously untaxed $10 million gain. Under Biden's proposed reforms, that capital gains tax bill would be roughly $4 million. That $4 million payment would be subtracted from the estate's $30 million value, leaving $26 million subject to the estate tax.

Except in the cases of family farms and businesses, "carryover basis" is not an acceptable alternative to ending stepped-up basis because it would still allow rich families to indefinitely dodge millions or billions of dollars in taxes.

- "Carryover basis" means that the inheritor of an asset keeps the same cost basis in that asset as the original owner, instead of changing the basis to the asset's value at the time of inheritance. If stock bought for $10 was inherited when it was worth $30, the cost basis would remain $10 for the inheritor just as it was for the original owner.
- But as with stepped-up basis rules, under carryover basis no tax is paid on a lifetime of capital gains enjoyed by the original owner unless and until the new owner sells the assets. In fact, under carryover basis infinite lifetimes of capital gains can still go completely untaxed if the underlying asset is never sold.
- Implementing carryover basis rather than ending stepped-up basis would raise roughly $100 billion, much less than repealing stepped-up basis altogether (combined with other changes to the taxation of capital gains). (CBO's explanation of carryover basis is here on p. 219.)
- Consistent with the views of more than a dozen members of Congress, the Biden plan recognizes that in the case of family farm and business assets, carryover basis is appropriate until such time as the assets are sold or cease to be used in the farm or business.

Rich people do not need to sell assets that have increased in value to benefit from the gain.

- Investment gains provide economic benefits to the rich even if they do not sell the assets that have gone up in value. The rich can borrow (at very low rates) against the value of their appreciated assets and live off those borrowed funds. They often can even get a tax deduction for the interest costs they pay to borrow the money.
- The gain from fast-appreciating investments in a hot stock or real estate market dwarfs the interest paid on loans they can secure. It's so common for rich families to use this tax-avoiding strategy that it even has a catchy name: Buy-Borrow-Die.
- ProPublica's report reveals the enormity of the buy-borrow-die tax avoidance strategy: Larry Ellison of Oracle had a credit line secured by $10 billion of his Oracle stock; Elon Musk had pledged 92 million shares of Tesla stock, currently worth over $50 billion, to secure personal loans; and Carl Icahn had several outstanding loans, including one from Bank of

America for $1.2 billion. Under the Biden plan, the costly and grossly unfair buy-borrow-die tax avoidance strategy would end.

Repealing stepped-up basis will stop a lot of tax cheating by rich inheritors.

- The higher the assigned cost of an inherited asset, the smaller the gain when it is eventually sold and thus the less tax due. Therefore, the next generation has an incentive to illegally inflate the stated value of inherited assets (unless the original owner's estate is so big it is the one in a thousand that is subject to the estate tax, in which case the incentive is to minimize asset values).
- Assessing capital gains taxes at the time of the death of the original owner takes away the heirs' ability to illegally evade taxes through inflated asset valuations.

Repealing stepped-up basis will promote economic growth.

- Taxpayers who sell appreciated assets prior to death are required to pay tax on the gains they realize. By holding appreciated assets until death, they are able to avoid tax on their unrealized gains, even gains that have accrued over the course of decades. This distorts economic decision making by creating a financial incentive to hold unproductive assets, thereby creating a drag on the economy. This is especially true for those in the last decade or so of life.
- Biden's reform of stepped-up basis equalizes the overall tax treatment of those who sell appreciated assets prior to death and those who hold appreciated assets until death, thereby removing an impediment to better economic decisions.

Stepped-up basis allows multiple applications of another special tax break for the rich.

- The basis of an asset is usually its purchase price, but it is sometimes lowered by tax breaks known as "depreciation" and "amortization." Rich owners of expensive physical assets like office buildings use depreciation to get annual tax breaks that are supposed to represent declining value from wear and tear.
- But owners are allowed to depreciate their assets for tax savings much faster than they really wear out. They have to lower the cost basis of depreciated assets, however, so some of this depreciation tax savings is "recaptured" when the asset is sold.
- Owners of assets like sports teams—in which a lot of the value resides in intangibles like the brand name and goodwill of fans—are similarly allowed to "amortize" those intangibles for yearly tax savings, but with the corresponding reductions in cost basis.
- Stepped-up basis, by wiping out these cost-basis adjustments, allows inheritors of depreciated and amortized assets not only to dodge recapture of those unfair tax savings from the past, but start their own depreciation and amortization with a fresh slate.
- **Prime example: billionaire owners of professional sports teams.** As of January 2021, according to analysis by Americans for Tax Fairness and the Institute for Policy Studies, 64 American billionaires owned or co-owned 68 professional sports franchises. A large portion of the purchase price of sports teams is allocable to goodwill and other intangible assets, and can be amortized over 15 years, creating millions in income tax savings. According to ProPublica's reporting, the deductions generated by sports-team ownership can reduce billionaire's taxes to less than those of their players. Stepped-up basis compounds this

problem. If the billionaire owner holds until death, as most do, and leaves the team to his spouse, those intangible assets can be amortized all over again. If the team passes to the children upon the spouse's death, a third round of amortization deductions can be claimed.

Recordkeeping challenges no longer justify stepped-up basis.

- The historical justification for stepped-up basis was the difficulty associated with figuring out what a decedent paid for long held assets. That is no longer the case. We have now had decades of centralized, electronic recordkeeping. Further, under the so-called *Cohan* rule, taxpayers can produce evidence to support an estimation of cost basis. The Biden plan would strengthen the protection of the *Cohan* rule by directing the Treasury Department to issue regulations establishing safe harbors for the estimation of a decedent's cost basis in assets where purchase-price records are not available.
- Most Americans will not face any issue with recordkeeping because of the exemption from tax on death ($1 million of gain per person, $2 million for a married couple). As of 2019, only 8% of adults (p. 42) had a net worth greater than $1 million.
- Those fortunate enough to have unrealized investment gains of greater than $1 million already need to maintain records of their cost basis in assets. Under current law, cost basis determines the gain on assets that are sold during lifetime and the basis taken by recipients of gifts. The challenge of locating purchase records is perhaps greater when the purchaser of an asset is deceased, but that is a difficulty those with substantial wealth should prepare for and have the resources to address.