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Steven M. Rosenthal is a former senior fellow and Robert McClelland is a senior fellow at the Urban-Brookings Tax Policy Center.

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In this article, Rosenthal and McClelland examine various proposals to tax unrealized gains, concluding that the best approach is to tax gifts and bequests of appreciated assets at death at a higher rate than during life.

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I. Introduction

Current law generally taxes capital gains only when realized and erases unrealized gains for tax purposes when inherited. This tax structure encourages wealthy investors to retain their appreciated assets — including stock, businesses, real estate, and other property — throughout their lifetime, "locking in" capital and perpetuating dynastic wealth among the richest Americans. We estimate that as of 2025, taxpayers worth more than $100 million held $13.4 trillion of unrealized gains.

If the United States taxed the unrealized gains of these wealthy taxpayers, it could potentially collect large sums of additional revenue while reducing economic inequalities.

This article discusses the major questions that must be addressed to design a new tax structure for unrealized gains, starting with who should be subject to the tax. It compares different approaches and concludes that the best solution is to tax unrealized gains at death at a higher rate than during life.

We believe taxing gains at a higher rate at death than during life would turn the existing incentive for holding appreciated assets on its head. Current law encourages people to avoid income taxes by holding their appreciated assets until death. Our proposal encourages them to avoid higher tax rates by selling appreciated assets well before they die. We also expect our proposal to minimize administrative burdens, by requiring assets to be appraised only once, at the owner's death, both for income and estate tax purposes.

II. Background

In general, income tax is due only upon the actual sale of property at a gain (the realization rule[1]). Before a sale, any increase in the value of property is unrealized gain or "paper profit."[2]

At the sale of property, the amount of taxable gain is the excess of the sale proceeds over the taxpayer's basis (generally the price the taxpayer paid for the property). If the taxpayer's basis exceeds the sale proceeds, the taxpayer may deduct the loss but, with a small exception, only

[1] For many years, Congress treated the realization rule as an administrative convenience, not a constitutional requirement. *See* Steven M. Rosenthal, "*Moore* Could Invalidate Decades of Tax Rules," *Tax Notes Federal*, Oct. 9, 2023, p. 285. But a recent decision by the Supreme Court undermines this view, as discussed in Appendix 2 of this article.

[2] If the property sold is a capital asset, the profit is capital gain. This article uses the term "property" interchangeably with "capital asset," although some property (like inventory) is not a capital asset. *See* section 1221, which excludes certain property, such as inventory, from the category "capital asset."

against gains (to prevent selectively taking losses to wipe out the taxability of regular income).[3]

In 1921 Congress first established a tax preference for profits from the sale of property, such as stock, businesses, real estate, and collectibles. At that time Congress lowered the top tax rate from 58 percent to 12.5 percent for profits from the sale of property held for more than two years. As reflected in the legislative history, Congress intended the preference to reduce what is now known as "lock-in" from high tax rates:

> The sale of farms, mineral properties, and other capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum . . . in the year in which the profit is realized. Many such sales, with their possible profit taking and consequent increase of revenue, have been blocked by this feature of the present law.[4]

Today, the top tax rate on the profitable sale of property that is held for more than one year is 20 percent, while gains on property held for one year or less are taxed at the ordinary income rate, which tops out at 37 percent. There is an additional tax of 3.8 percent for both the long- and short-term gains of higher-income taxpayers.[5]

Notwithstanding the lower tax rate for long-term capital gains, Congress left in place the realization principle, which has been labeled the "original sin" of the federal income tax.[6] As a result, taxpayers can still exploit a gap by holding their appreciated assets until death, when their gains escape income tax completely.[7]

Gains escape tax at death for two reasons. First, the transfer of assets at death is not a sale, so there is no income tax due from the estate of the original owner. And second, the tax basis of property that is received at death is stepped up to its value at the time of inheritance. Consequently, a recipient does not pay taxes on the capital gains that accrued on the property during the decedent's lifespan; the recipient is liable only for increases in the property's value after inheritance if sold.[8]

Thus, current law still encourages taxpayers to keep (lock-in) their investment until death, when any appreciation in their property escapes income taxes permanently.[9] And wealthy households respond disproportionately to this incentive because they have the most potential gains and consequently the greatest tax savings from not selling.[10]

The failure to tax unrealized gains results in "distorted allocation of capital and inefficient portfolio selection."[11] It also exacerbates economic inequality and contributes to dynastic wealth.[12] Finally, as we discuss below, it forgoes substantial tax revenue.

Addressing these shortcomings is pressing. First, unrealized gains have exploded over the last several decades, especially those held by the wealthiest. In 1966 Treasury estimated that the untaxed appreciation of assets of those estates required to file estate tax returns (at that time, those worth more than $60,000) was about $7 billion, or about a third of total estate assets of $21 billion.[13] But, by 2025, we estimate the unrealized gains of the very richest Americans (those with

[3]In 1976 Congress permitted a small amount, $3,000, to be deducted against ordinary income. Joint Committee on Taxation, "General Explanation of the Tax Reform Act of 1976," JCS-33-76, at 425 (1976) ("Because taxpayers have discretion over when they realize their capital gains and losses, unlimited deductibility of net capital losses against ordinary income would encourage investors to realize their capital losses immediately to gain the benefit of the deduction against ordinary income but to defer realization of their capital gains.").

[4]H.R. Rep. No. 67-350, at 10-11 (1921).

[5]Section 1411, the tax on net investment income. For wages and other compensation, the top rate is 37 percent plus a 3.8 percent payroll tax.

[6]*See* Joseph Bankman et al., *Federal Income Taxation* 230 (2019) ("Many tax scholars believe that the realization doctrine is the original sin of the federal income tax.").

[7]The total value of the assets themselves may be subject to the estate tax to the extent they exceed an exemption amount, about $28 million per couple in 2025.

[8]Section 1014.

[9]For an appreciated asset to be stepped up in basis, it must be included in an estate. Then, the value of the asset (and any other assets) would only be subject to estate tax.

[10]The motivation for the wealthy to hold and amass more assets is hard to quantify, although a large factor is the importance of retaining control over their wealth, including by their posterity. *See* Wojciech Kopczuk, "Taxation of Intergenerational Transfers and Wealth," 5 *Handbook Pub. Econ.* 329 (2013).

[11]*See* Alan J. Auerbach, "Retrospective Capital Gains Taxation," 81 *Am. Econ. Rev.* 167 (Mar. 1991).

[12]William G. Gale, Oliver Hall, and John Sabelhaus, "Taxing the Great Wealth Transfer," Brookings (Dec. 2024).

[13]Jerome Kurtz and Stanley S. Surrey, "Reform of Death and Gift Taxes: The 1969 Treasury Proposals, the Criticisms, and a Rebuttal," 70 *Colum. L. Rev.* 1365, 1382 (1970). An additional $4.5 billion passed from decedents whose estates did not file estate tax returns because the estate value fell beneath the exemption amount.

more than $100 million net worth) are about $13.4 trillion — more than half (56 percent) of their total $23.9 trillion of wealth.[14]

Second, the average age of the richest holders of unrealized gains is now 69, so the prospect of their gains permanently escaping tax upon their death looms.[15]

III. Designing a Tax on Unrealized Gains

A new tax on unrealized gains would raise five major questions:

1. Who would be subject to the tax?
2. What administrative issues would be created?
3. How would losses be treated?
4. How would the transition to the tax be handled?
5. Would the tax be constitutional?

A. Taxpayers Subject to the Tax

Taxing capital gains is inherently progressive because most capital gains, both realized and unrealized, are held by households with very high income or wealth. Several recent proposals have set an income or wealth floor to make these proposals even more progressive — and to avoid imposing administrative costs that may be high relative to the revenue collected. An income floor (including capital gains) would encourage some taxpayers to defer or accelerate realizations to stay under the floor.[16] A wealth floor would be harder to manipulate. A phase-in range would further discourage manipulations.

In this article, we compare proposals that apply to single filers or couples with net worth above $100 million, with the tax phased in on wealth between $100 million and $200 million.[17] The phase-in feature means the proposals would not apply to the unrealized gain of a taxpayer with a net worth of $100 million or less: They would apply to half the unrealized gain for a taxpayer with a net worth of $150 million and to all the unrealized gain for a taxpayer worth $200 million or more. The phase-in reduces the unrealized gain to be taxed from $13.4 trillion to $12.6 trillion.

B. Potential Administrative Issues

The applicability of the taxes that we explore depends on a taxpayer's net worth. But calculating net worth requires valuations, which are notoriously difficult for nonpublicly traded property, and sometimes difficult even for publicly traded property (for example, large blocks of stock are hard to value based on smaller-sized transactions). Also, without actual sales, taxpayers who own either publicly traded or nonpublicly traded property might not have cash available to pay the tax.[18]

Some of the administrative problems from valuation may be mitigated by exempting assets with small values. Administrative problems from valuation also may be reduced by a tax that requires assets to be valued only at death rather than annually.

Apart from valuations, taxpayers would have strong incentives to hide assets, including by shifting them abroad (which would require the IRS to track them down). Alternatively, taxpayers might hold assets within complicated financial structures to conceal ownership. Or they might transfer ownership to a trust or other entity to avoid a tax at death.

After the unrealized gain in an asset is taxed, a taxpayer's basis in the asset must be increased to avoid taxing the same gains again later. Taxpayers must make these calculations, which may impose additional administrative burdens.

[14] Those with more than $200 million had $10 trillion in unrealized gains. Calculations by the authors using the 2022 Survey of Consumer Finances and the *Forbes* 400, extrapolated to 2025. Growth rates drawn from Gale, Hall, and Sabelhaus, *supra* note 12. *See also* Zachary Tashman and William Rice, "The Ultra-Wealthy's $8.5 Trillion of Untaxed Income," Americans for Tax Fairness (Jan. 3, 2024).

[15] Calculations by the authors. For an individual at age 69, the average life expectancy is 14.3 years for men and 16.7 years for women. Social Security Administration, "Period Life Table, 2021." The average life expectancy for the rich is somewhat longer. Raj Chetty, Michael Stener, and Sarah Abraham, "The Association Between Income and Life Expectancy in the United States, 2001-2014," 315 *JAMA* 1750 (2016)

[16] Robert McClelland and Karen E. Smith, "Can Millionaires Avoid a Surtax on Their Long-Term Capital Gains?" Urban-Brookings Tax Policy Center (Dec. 21, 2023).

[17] We estimate there would be a total of 55,000 to 70,000 taxpayers.

[18] The wealthy generally can access cash more easily to pay tax, but some still might struggle.

C. Treatment of Losses

If unrealized gains are included in income, should unrealized losses be deductible? In many instances, deductions for unrealized losses are necessary to properly measure income, which economists define as the change in a person's net worth plus the person's consumption.[19] However, if taxpayers could selectively deduct unrealized losses but not realize gains, they could distort their income. For example, under current law, investors can sell depreciated assets during their lifetime and deduct the losses, but bequeath appreciated assets at their death without realizing the gains — an improper advantage.

D. Transition to New Tax Regime

To mitigate the financial shock, a new tax for unrealized gains could exempt gains that arose before the tax's effective date. But it would then require taxpayers to distinguish between appreciation that occurred before and after the effective date, which adds complexity.

Moreover, a new tax that applied only to unrealized gains that arose after the effective date of the tax would forgo substantial revenue. As noted above, taxpayers with more than $100 million net worth collectively have about $12.6 trillion of unrealized gains, after reduction by the phase-in range. So the question of whether to tax these accumulated gains has great financial significance.

Lawmakers sometimes delay the effective date of a new tax, either to allow taxpayers to better understand the tax or to lessen the incentive to react quickly before the tax takes effect. However, if unrealized gains were to be taxed at the same rate as realized gains, there would be no preemptive action investors could take to avoid the tax.

E. Constitutionality of New Tax

In 2024 the Supreme Court decided *Moore*, in which the plaintiffs challenged a one-time retroactive provision in the 2017 Tax Cuts and Jobs Act requiring investors to pay a tax on undistributed profits earned by American-controlled foreign corporations.[20] The plaintiffs argued that the provision was unconstitutional because undistributed profits are not "income" within the meaning of the U.S. Constitution's 16th Amendment, which authorizes income taxes.

The Court held that the income that had been realized by the company was effectively realized by its owners as well; hence, the Moores' share of the business's undistributed profits could be taxed in accordance with the 16th Amendment.

The Court expressly did not address whether "taxes on appreciation" were permissible income taxes. But four justices, just one short of a majority, appeared ready to rule that (1) appreciation on property that has not been sold is not income, and (2) a tax on the unrealized appreciation would not be constitutional unless the tax was apportioned (apportionment requires Congress to allocate the total tax liability to each state according to its population). But some taxes on unrealized gains are more clearly constitutional, as discussed further in Appendix 2.

IV. Proposals to Tax Unrealized Gains

There are several approaches to reforming the tax treatment of unrealized gains to unlock assets, reduce wealth inequality, and raise revenue. Below, we discuss five options:

1. Carry over basis at death (that is, end the step-up in basis to fair market value at the time of inheritance).
2. Require that tax be paid on borrowing while holding appreciated property, a technique some investors use to avoid capital gains taxes.
3. Tax unrealized gains annually (that is, a mark-to-market method of accounting, which would treat appreciated property as if it were sold every year).
4. Charge "lookback" interest on prior years' appreciation of property at the time the property is ultimately sold.
5. Treat gifts or bequests of appreciated property as sold and taxed at either capital gains or ordinary income rates.

[19] This is the Haig-Simons definition of income. *See* Robert M. Haig, "The Concept of Income — Economic and Legal Aspects," *The Federal Income Tax* (1921); and Henry Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (1938).

[20] *Moore v. United States*, 602 U.S. 572 (2024).

In comparing these different approaches, we assume that each proposal would apply only to taxpayers with more than $100 million, with a phase-in between $100 million and $200 million net worth. We explore in greatest detail the fifth option, which we favor: treating property that is held until death as sold and taxed at a higher rate than property that is sold during life.

A. Carryover Basis at Death

Today, taxpayers can avoid income tax on their appreciated property by giving it away, typically transferring it to family members or charities. But, unlike an inheritor, the recipient of that gift of property carries over the transferor's basis.[21] As a result, a recipient of a gift of appreciated property still may pay tax on the property's total appreciation upon a later sale.

Some have proposed extending the carryover basis rule to bequests at death, which currently permits basis to be stepped up to fair market value.[22] Under a carryover rule, the inheritor would assume the decedent's basis at death and pay tax later on the total gain if one still exists when the property is ultimately sold.

Thus, a carryover basis at death would preserve a potential income tax on appreciated property. It also would avoid the need to appraise the property to determine its value — or to collect a tax in the absence of a sale.[23] That is because any gain, and any tax, would be due only upon a later sale of the property. However, the inheritor of the property still must obtain the decedent's basis, which requires the decedent to maintain good recordkeeping.

In the Tax Reform Act of 1976, Congress required a recipient of inherited assets to use a carryover basis (rather than step-up) to determine gains or losses for a later sale of the property.[24] The provision allowed gains that accrued before 1976 to continue to be stepped up. And, to avoid a double tax on appreciation, the recipient could adjust the carryover basis of property subject to federal and state estate taxes, an adjustment that proved complicated to make.[25]

But Congress repealed the carryover rule within four years, retroactively. The repeal was attributable largely to public objections to recordkeeping, mainly the challenge of reconstructing cost basis for inherited assets.[26] Recordkeeping today is very much easier, with securities brokers retaining historic tax basis information as standard practice and with other significant advances in data technology. Also, a high threshold for those who would pay the tax would lessen the administrative burdens (though a threshold would then require net worth determinations).

Most importantly, however, a carryover of the basis would increase the incentive to defer sales (compared with the step-up regime) because the unrealized gains and potential taxes from selling the property that was received at death would be higher. Taxpayers also might defer sales in the hope that Congress would eventually repeal the carryover rule, as it has done before.

In theory, a carryover rule would in time raise more revenue than the current step-up system because gains would never disappear for tax purposes. But it might aggravate the lock-in effect as inheritors shied away from paying their tax on ever-growing gains, hoping for repeal. The deferral of the tax would also push revenue many years into the future, even assuming Congress would not repeal the rule again.

We estimate that, without transition relief, a carryover basis for inheritances received from estates worth more than $100 million would generate about $42 billion of additional revenue over the 2025 to 2034 time period (see table).

[21] Section 1015.

[22] Section 1014. *See, e.g.*, Richard Schmalbeck, Jay Soled, and Kathlene Delaney Thomas, "Advocating a Carryover Tax Basis Regime," 93 *Notre Dame L. Rev.* 109 (2017).

[23] *See* Lawrence Zelenak, "Taxing Gains at Death," 46 *Vanderbilt L. Rev.* 361, 367 (1993).

[24] Congress did not limit losses on property received with a carryover basis from a decedent. It reasoned that a decedent could not "selectively transfer only loss assets since all of the assets of the decedent must pass at the death of their owner." JCS-33-76, *supra* note 3, at 553.

[25] *See* Zelenak, *supra* note 23, at 368.

[26] Schmalbeck, Soled, and Thomas, *supra* note 22. *See also* Harry L. Gutman, "Taxing Gains at Death," *Tax Notes Federal*, Jan. 11, 2021, p. 269.

Comparison of Estimated Revenue

Policy Change	Revenue Change 2025-2034 ($ billions)
Carryover basis	$42
Borrowing	$108
Mark-to-market	$1,146
Lookback interest	Negligible
Tax at death at 40.8%	$851
Source: Authors' calculations, Appendix 1.	

B. Borrowing as a Taxable Event

Currently, taxpayers may borrow cash to fund their consumption during their lifetimes, to avoid selling their appreciated assets (and paying income tax). Proceeds from loans are not subject to tax. (The logic is that borrowing may increase a taxpayer's assets, but the obligation to repay increases the taxpayer's liabilities by the same amount.) This tax avoidance strategy of the super wealthy is known as "buy, borrow, die."[27]

Several commentators have proposed treating borrowing while holding appreciated assets as equivalent to selling the assets (that is, treating the borrowing as a taxable event).[28] Most prominently, professors Edward Fox and Zachary Liscow proposed to treat a taxpayer who borrowed money as selling an equivalent value of appreciated property, regardless of whether the loan was secured by the property.[29]

For example, suppose a taxpayer acquired property for $1 million that is now worth $10 million. The proposal would treat $10 million worth of subsequent borrowing as equivalent to selling $10 million of the taxpayer's earliest-acquired appreciated assets (regardless of whether the borrowing was secured by those assets). In this example, the taxpayer would realize $9 million of imputed gain. The taxpayer's basis in the property that was deemed sold would be increased to avoid double taxing gains.

Treating borrowings as taxable raises serious valuation challenges because assets would be deemed to be sold at a certain price without an actual market transaction to set that price. To reduce these valuation challenges, the Fox and Liscow proposal would limit the realization of gains to "major assets," which they define as significant shares in business interests or other major holdings.[30] But we estimate that approximately half the assets of the very wealthy are significant business interests that are not publicly traded, so valuation issues would arise often.[31]

Moreover, a tax on borrowings by the very rich (for example, those with more than $100 million of net worth) would require ongoing determinations of net worth (unlike a tax that applies only once, at death). Ongoing net worth calculations raise further valuation issues.

Finally, the tax would need rules for borrowings by controlled entities, tiered partnerships, trusts, and other related parties. These rules would add complexity and might still leave potential loopholes.

Fox and Liscow's proposal would apply both to current and future borrowings (and they estimate most of the revenue from their proposal would come from current loans, not future ones). Nevertheless, borrowings account for only a small fraction of the unrealized gains of the wealthy.[32] So even if borrowings were treated as the sale of an equivalent amount of appreciated assets, unrealized gains would still largely go untaxed, and dynastic wealth would be perpetuated.

In the Federal Reserve's most recent Survey of Consumer Finances, reporting conditions in 2021, those with more than $100 million net worth have

[27] Professor Ed McCaffery first coined the phrase "buy, borrow, die." Matthew Kredell, "'Buy, Borrow, Die' Gains New Life," USC Gould School of Law News, Aug. 30, 2021.

[28] *See, e.g.*, McCaffery, "Taxing Wealth Seriously," 70 *Tax L. Rev.* 305 (2017).

[29] Fox and Liscow, "No More Tax-Free Lunch for Billionaires: Closing the Borrowing Loophole," *Tax Notes Federal*, Jan. 22, 2024, p. 647.

[30] *Id.* at 649. Fox and Liscow would exclude assets like homes and art.

[31] The authors' calculations for taxpayers with more than $100 million of net worth are from the 2022 Survey of Consumer Finances data.

[32] Fox and Liscow recently documented further the relatively small amounts of borrowing by the rich in "The Role of Unrealized Gains and Borrowing in the Taxation of the Rich," University of Michigan Law School, Law and Economics Research Paper No. 24-041 (last revised Feb. 18, 2025).

a relatively modest $172 billion in borrowings outstanding.[33] Fox and Liscow identify an additional $185 billion of borrowings by the *Forbes* 400 as of November 2021 (which the Fed would not count).

We estimate that treating borrowings as realizations by those with a net worth of $100 million or more, using a phase-in to $200 million, would generate about $108 billion from 2025 to 2034.

C. Mark-to-Market Accounting

Sen. Ron Wyden of Oregon, the top Democrat on the Senate Finance Committee, has proposed requiring taxpayers to pay tax annually on any increase in the value of their assets (a mark-to-market method of accounting).[34] Wyden would apply his new tax only to those with more than $1 billion in assets, or $100 million in income, for three consecutive years.

Wyden's proposal would tax investors' gains in their publicly traded assets as if they sold those assets at the end of each year — beginning with all the gains accumulated before the law's enactment. For example, suppose long-time billionaire Mark Zuckerberg owns $100 million of Meta stock, for which he paid nothing when he founded the company decades ago. In the first year, he would be required to pay capital gains tax on $100 million of income even if he didn't sell any Meta shares. The next year, he would pay tax on any additional increase in the value of his stock beyond $100 million.

Wyden proposed special rules for assets that are not publicly traded, such as homes, art collections, and, most importantly, privately held businesses. For these assets, taxpayers would delay paying tax until they actually sell or otherwise dispose of them, including at death, and then they (or their estate) would pay the tax plus a lookback interest charge, similar to the next proposal we address here.

Wyden would permit deduction of net losses from the deemed sale of publicly traded assets to reduce taxable income — as is fair, if deemed gains are to add to it. But Wyden's proposal permits losses only to the extent of gains, with a three-year carryback for the losses. In theory, to determine income correctly, Wyden should instead allow a deduction for all unrealized losses, regardless of whether there are corresponding gains, with the surplus losses subtracted from other forms of income when determining taxable income.[35] Otherwise, billionaires who realize large gains in one year and large losses several years later might never receive the proper tax benefit of their losses. In other words, they would be responsible for the full tax consequences of treating unrealized gains as realized but not enjoy the commensurate tax benefits of treating unrealized losses as realized.

Wyden's special rules for nonpublicly traded property are designed to avoid the challenges of valuing assets for property that has not been sold. But introducing different rules for publicly traded and nonpublicly traded property introduces new discontinuities (and may discourage private companies from going public). It also adds to complexity. And for many taxpayers, taxing so-called paper profits is counterintuitive. For those reasons and perhaps others, mark-to-market taxation is politically unpopular.[36]

Moreover, while only a few taxpayers would pay the new tax, many more would need to value all their assets annually, including their privately held businesses, to determine if they are subject to it. Taxpayers close to the asset threshold might move in and out of the new tax regime annually.

Finally, and perhaps most importantly, an annual tax on appreciation of publicly traded assets raises serious constitutional questions in light of the recent Supreme Court decision in *Moore*. (See Appendix 2 for a discussion of the constitutional questions with taxing unrealized gains.)

[33] Borrowing among all surveyed is much larger: $16.7 trillion. The Federal Reserve's survey data generally does not count borrowing by controlled entities and related parties.

[34] Finance Committee release, "Wyden Unveils Billionaires Income Tax" (Oct. 27, 2021).

[35] Alternatively, Wyden could allow losses to be carried back to offset any gains from an earlier mark-to-market.

[36] Liscow and Fox, "The Psychology of Taxing Capital Income: Evidence From a Survey Experiment on the Realization Rule," 213 *J. Pub. Econ.* 104714 (June 2022).

The Biden administration recommended a similar approach to collect taxes on appreciated property annually.[37] It raises similar administrative and constitutional issues as Wyden's proposal.

We estimate that Wyden's proposal to tax unrealized gains on publicly traded assets with an interest charge on realized gains on nonpublicly traded assets would raise about $1.1 trillion from 2025 to 2034 if it was applied to those with more than $100 million net worth (see table).[38] This estimate is substantially larger than the estimate by the Joint Committee on Taxation because we lowered the threshold from $1 billion to $100 million, with a phase-in to $200 million.

D. Lookback Interest Charge

Some have suggested adding an interest charge to the taxes owed at the time of the eventual sale of an appreciated asset, to remove the tax incentive to delay selling.[39] As Alan Auerbach observed: "The effect is to simulate a system under which capital gains taxes are computed on an accrual basis [that is, mark-to-market], but collected, with interest only upon realization."[40]

Under this approach, an interest fee is charged based on how long the property was held before sale. By increasing the eventual tax bill the longer an appreciated asset is held, investors may be prompted to sell earlier, potentially overcoming the lock-in effect and raising tax revenue more quickly.

A lookback charge requires a schedule to be constructed to approximate the path of the accrued gains until the sale, which determines the amount of deferred taxes and the interest due on them.[41] For simplicity, the accrual generally is assumed to be ratable.[42]

There are several advantages to a lookback interest charge compared with the annual mark-to-market alternative described above. Because no tax is imposed until the actual sale of property, the base capital gains tax is easily determined, as under current law. So there is no need to value the property in advance of sale, which can raise difficult administrative issues, especially for nonpublicly traded property. The lookback approach also avoids liquidity issues because the taxpayer can use a portion of the eventual sale proceeds to pay the tax. Presumably, the determination of who would be subject to the interest charge also would be delayed until sale (to apply, for example, to taxpayers with more than $100 million of assets), to prevent interest from turning on and off annually.

But the hypothetical price path of accrued gains may not match the actual price path.[43] For example, unrealized gains might not increase steadily over the deferral period (for example, they might increase most sharply right at the start or, alternatively, right before the eventual sale). As a result, the deferral charge method could still leave substantial lock-in effects in place for some assets.

The main defect in the plan, though, is that tax (and interest) can still be delayed indefinitely. Thus, interest charges might not be collected for many years and might never be collected if the interest charge is repealed first by a later Congress. In fact, increasing the tax rate with an interest charge also increases the incentive to hold assets until death, when the assets could pass to

[37] Treasury, "General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals" (Mar. 11, 2024) (fiscal 2025 green book).

[38] We adjust this estimate for a phase-in between $100 million and $200 million of net worth.

[39] Economist William Vickery is credited with originally conceiving of a lookback charge for deferred sales. *See* Vickery, "Averaging Income for Income Tax Purposes," 47 *J. Polit. Econ.* 379 (1939).

[40] *See* Auerbach, *supra* note 11.

[41] In lieu of a lookback charge, Auerbach proposed a retrospective capital gains tax, which would impute interest income at the time of the eventual sale. The tax would thus depend solely on the sale proceeds and the holding period, not the purchase price (or an accrual schedule for gain). But, under Auerbach's approach, a tax could be positive, even if the asset were sold at a loss, which raises some of the constitutional questions that are discussed in Appendix 2.

[42] A lookback charge already exists for gains from the sale of passive foreign investment companies. Sections 1291-1298. If a shareholder invests in a PFIC and does not elect to include income from the PFIC annually, there is an interest charge on the gain on the later sale of the PFIC. The gains are assumed to have accrued ratably over the shareholder's holding period.

[43] Eric Toder and Alan D. Viard, "A Proposal to Reform the Taxation of Corporate Income," Urban-Brookings Tax Policy Center (June 2016).

heirs free of capital gains, taxes, and interest (assuming step-up in basis is still in effect).[44]

E. Taxing Transfers of Appreciated Property

Proposals to tax transfers of appreciated property have been around for several decades, starting in 1963 with a Kennedy administration proposal.[45] In 1969 Treasury published a study on tax reform that recommended taxing the gains in gifts of appreciated property and bequests at death.[46] In 1977 Treasury again proposed to treat tax transfers by gift or at death as taxable events subject to the same tax rates applicable to other realizations of capital gains.[47] The Obama and Biden administrations likewise proposed to tax the gains in gifts and bequests of appreciated property at the same rate as capital gains for sales (albeit at a higher rate than was then in place both for gains during lifetime and at death). The Obama proposal would have exempted the first $100,000 of gains for singles, $200,000 for couples. The Biden proposal would have exempted the first $5 million of unrealized gain for singles, $10 million for couples.[48] But these recent proposals, like the earlier ones, have languished.

Our proposal also would tax the unrealized gains of the ultrawealthy (those with a net worth of more than $100 million) upon gift or death.[49] But unlike earlier proposals, we would apply a higher tax rate for bequests at death (40.8 percent) than for gifts during life (23.8 percent).[50]

For example, imagine an entrepreneur who owns $200 million of her company stock, for which she paid nothing when she founded the firm. If she sells during her lifetime, she would owe $47.6 million in capital gains tax (a $200 million gain taxed at the top capital gains rate of 20 percent, plus the 3.8 percent tax on net investment income). But if she holds the stock until death, under our proposal her estate would owe $81.6 million in income tax (a $200 million gain taxed at the top regular income rate of 37 percent, plus 3.8 percent to mirror payroll taxes). If she wants to transfer the stock to her children without their inheritance being reduced by nearly $81.6 million, she could give the stock to them during her lifetime and pay $47.6 million instead.

1. Design details.

Our proposal, like the Obama and Biden proposals, would tax the gains in gifts and bequests of appreciated property.

As with the Obama and Biden proposals, we would treat a gift or bequest of appreciated property as a sale of the property. The donor or estate of the deceased owner of an appreciated asset would realize a gain at the transfer, equal to the excess of the asset's value on the date of the transfer over the donor's basis in that asset. The tax would not apply to a transfer to a spouse. In these circumstances, the spouse would carry over the basis of the donor (and tax would be due when the spouse later disposed of the property or died). To avoid double taxation, taxpayers could deduct the income taxes on unrealized gains for estate tax purposes (that is, the taxable value of the estate would be reduced by the taxes paid on unrealized gains at death).[51]

[44] The Penn Wharton Budget Model estimated several variations of lookback charges, one of which also taxed unrealized gains at death (at a tax rate increased by an interest charge). In some respects, this variation is similar to our approach, although the tax rates differ significantly. Penn Wharton Budget Model, "Capital Gains Taxation and Deferral: Revenue Potential of Reform" (Mar. 7, 2022).

[45] Hearings on President's 1963 Tax Message Before the House Committee on Ways and Means, 88th Cong. 2d Sess. (1963).

[46] Committee Print, "Joint Publication of the House Committee on Ways and Means and the Senate Finance Committee on Finance, Tax Reform Studies and Proposal, U.S. Treasury Department," pt. 1, at 28-29 (Feb. 5, 1969).

[47] Treasury, "Blueprints for Basic Tax Reform" (Jan. 17, 1977).

[48] *See* Treasury, "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals" (Feb. 2016) (2017 green book); and fiscal 2025 green book, *supra* note 37. The Biden proposal allowed a $5 million per-donor exclusion of unrealized capital gains on property transferred by gifts or bequest (and the $5 million would be portable to a surviving spouse).

[49] To determine a taxpayer's net worth at death, the taxpayer would add his or her reportable gifts made during life.

[50] The higher tax rate would apply to gain on any asset already included in the gross estate by reason of having been gifted in contemplation of death (*i.e.*, within three years of death). Section 2035(a).

[51] The Obama and Biden proposals also permit taxpayers to deduct capital gain *taxes* paid at death from the estate tax. By contrast, a recent Congressional Budget Office revenue option would permit taxpayers to deduct the *capital gains* taxed at death from estate taxes to avoid taxing the same appreciation under both taxes. CBO, "Options for Reducing the Deficit: 2025 to 2034" (Dec. 2024) (option 51). However, permitting taxpayers to deduct capital gains rather than capital gain taxes, would exacerbate the lock-in effect (*i.e.*, any appreciation at death would then be taxed at 23.8 percent under the income tax rather than 40 percent under the estate tax).

In general, our plan would tax gains on publicly traded and nonpublicly traded property at the same rate, reducing market distortions. However, our plan would extend the existing tax relief for actively held farms and family businesses under estate tax rules. Thus, if the value of an interest in an actively held business exceeds 35 percent of the adjusted gross estate, we would allow the tax to be deferred for up to 14 years.[52]

Our proposal departs from the earlier proposals in three major ways. First, we would apply the tax only to single filers or married couples worth more than $100 million, with a phase-in to $200 million (a much higher threshold than any of the earlier gain-at-death proposals). Second, we would continue to apply a lower capital gain rate (23.8 percent) to sales, gifts, and other dispositions (including a taxpayer's mark-to-market election, which is described below) of appreciated assets during the taxpayer's lifetime, but the higher ordinary income rate (40.8 percent) for transfers at the death of the taxpayer. Finally, we would suspend losses for gifts of depreciated assets. Otherwise, a donor might give away these assets to accelerate losses that could be used to lower reported income and income tax due. The donor also might manufacture a loss by deflating the value of the property.[53]

But we would generally allow the estate of a deceased taxpayer to deduct suspended and unrealized losses on the final personal income tax return to offset any realized or unrealized gains. The reason for the different treatment of losses in bequests and gifts is that there is no possibility of selective realization of losses at death because all property must be transferred.

Any losses that are unused on the decedent's final tax return would expire, as under current law.[54]

Our proposal would add antiabuse rules for transfers to trusts and other entities.[55] These rules would, for example, impose an income tax on any transfer of appreciated property to a trust, whether or not the trust is subject to estate tax on the transferor's death. The rate would be 23.8 percent for transfers during life, and 40.8 percent for transfers at death (or within three years of death).[56]

Our proposal would be effective for transfers after December 31, 2024, and apply to appreciation arising before or after that date.[57]

2. Advantages of taxing gains at a higher rate at death.

There are several substantial advantages to our proposal.

Most importantly, we would tax capital gains at death at the higher ordinary income rate because there is no need to lower tax rates for capital gains at death. That is, there is no need to combat asset lock-in with a discounted rate because the assets can no longer be retained by the original owner. We would deem a gift or sale that occurs within three years of death as occurring at death (and subject to the higher tax rate).[58] This would limit deathbed gifts and below-market sales, much like current estate tax law limits these transfers before death.[59]

We would allow taxpayers to elect to treat an appreciated asset as sold, and repurchased, at the end of any year (a mark-to-market election).[60] That would allow taxpayers to pay a lower tax on the appreciation yet still retain the property, such as a family business. However, we would not allow a

[52] Section 6166.

[53] Zelenak, *supra* note 23, at 436.

[54] *See* Rev. Rul. 74-175, 1974-1 C.B. 52.

[55] For a detailed discussion of potential abuses and approaches to address them, see American College of Trust and Estate Counsel, "Report on Proposals to Tax the Deemed Realization of Gain on Gratuitous Transfers of Appreciated Property" (Oct. 15, 2019).

[56] For assets held in long-term trusts, including those transferred prior to the effective date of the new tax, Congress could follow Canadian law, which generally deems property held in a trust to be sold for its fair market value every 21 years after the trust is established. *Id.*

[57] Taxing appreciation only after the effective date would add administrative complexity, requiring a valuation of all property not only at the time of sale but also as of the effective date of the proposal. JCT, "Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2016 Budget Proposal," JCS-2-15 (Sept. 2015). For further design suggestions, see Zelenak, *supra* note 23. *See also* Joseph M. Dodge, "Further Thoughts on Realizing Gains and Losses at Death," 47 *Vanderbilt L. Rev.* 1827 (1994).

[58] For gifts during a taxpayer's life, the taxpayer may not know whether the new income tax would be applicable, which would be determined at death (and collected then for the earlier gifts, at a 40.8 percent rate).

[59] Section 2035. We also would tax extraordinary dividends within three years of death at ordinary rates later. See, by analogy, section 1059.

[60] If a taxpayer makes this election within three years of death, the sale would be subject to tax at death at the rate of 40.8 percent. Once made, the election would apply for all future years.

loss at death on nonpublicly traded property that previously had been marked to market. Otherwise, a taxpayer might inflate the value of an asset at an earlier mark to completely eliminate gains at death that otherwise would be taxed at a higher rate.

We would expect cautious taxpayers to accelerate the sale of their assets (or make the mark-to-market election). They can't predict when they might die — but they face the specter of a higher tax rate on their unrealized gains when they do.

As a result, our proposal effectively reduces lock-in effects during one's lifetime without rising rates before death, because the advantage of holding for a longer period is offset by the risk of dying and paying a higher tax rate. This would be especially true at older ages, as the mortality risk rises.

Our recommendation turns the existing tax incentive to hold appreciated assets on its head. Instead of encouraging people to hold their appreciated assets until death to avoid income taxes, our proposal encourages them to sell these assets well before they die (or elect to mark-to-market their appreciated property).

Another benefit of our plan is that it would cause little added administrative burden for taxpayers and the IRS. Our proposal would apply only to the superrich, those with more than $100 million net worth (with a phase-in until $200 million). A high floor reduces the number of potential taxpayers (and limits the tax to those who, because of their resources, could most easily manage the administrative burden). We would offer larger exemptions than other plans for tangible property and other personal effects since relatively little revenue would be lost.

Taxpayers who are wealthy enough to be subject to our tax would by definition also be required to file an estate tax return. They therefore would be spared the cost and trouble of a separate appraisal of assets to determine gains by using the valuations already necessary for estate tax purposes. As a related matter, our proposal would not require valuations of assets held at the effective date of the tax since we would tax assets acquired before and after the effective date the same way. We also would tax gains on publicly traded and closely held property at the same rate, minimizing discontinuities — and market distortions.

Finally, taxing unrealized gains at death might have bipartisan appeal because President Trump, in 2016, proposed to tax unrealized capital gains held until death, with an exemption of $5 million ($10 million for married couples).[61]

3. Disadvantages of taxing gains at a higher rate at death.

Under our proposal, two taxes would be collected at death: the estate tax of 40 percent on the entire value of the property exceeding the exemption amount, and an income tax of 40.8 percent on the property's gain in value over the decedent's lifetime. Some would argue this "double" tax on the same property is inappropriate. But the income and estate tax use different bases and function independently. We already tax the income from capital gains realized during life under the income tax while taxing wealth at death through the estate tax. There's no reason gains remaining at death should escape this dual system.[62]

Some would accept both taxes but argue that the total tax is excessive. Under our proposal, the top effective tax rate at death for property (with zero basis) would be 64 percent [0.408 + (1 - 0.408) * 0.4]. But that figure only seems large compared with the low estate tax rates in effect in recent decades. The combined capital gains and estate tax rate we propose is lower than the rates charged on estates alone in the middle of the 20th century (70 percent from 1934 until 1940 then 77 percent until 1982).[63]

Moreover, this 64 percent rate assumes an estate consisting entirely of unrealized gains, an unlikely scenario. As noted earlier, we calculate

[61] Jim Nunns et al., "An Analysis of Donald Trump's Revised Tax Plan," Urban-Brookings Tax Policy Center (Oct. 18, 2016). Though President Trump's plan was paired with a repeal of the estate tax. Similarly, Canada imposes a tax on unrealized gains at death, without an estate tax.

[62] *See* Kurtz and Surrey, *supra* note 13, at 1383-1384.

[63] Some states also impose estate taxes, which could increase the top effective rate at death past 64 percent. In 1924, Congress allowed a dollar-for-dollar federal tax credit for death taxes (estate, inheritance, legacy, and succession taxes) paid to a state, up to a specified maximum amount. Revenue Act of 1924, P.L. 68-176, section 301(b). Congress ended this credit for "pick-up" taxes in 2001 but could restore it now. By doing so, Congress could limit the top effective rate of our proposal — and share some of the new revenue with states.

that those with more than $100 million net worth hold an average of 56 percent of their assets as unrealized gains, meaning 44 percent of the value of the estate of such a taxpayer would not be subject to our capital gains tax. Setting aside the phase-in, the top effective tax rate would be about 53 percent [(0.56 * 0.64) + (0.44 * 0.4)], which is lower than the top rate of the estate tax historically.[64]

Some also might perceive the jump in tax rates at death as unfair (it might, for example, exacerbate the tragedy of an unexpected death). But our proposal allows taxpayers to realize their gains earlier (they may elect to treat their property as sold annually). Alternatively, cautious taxpayers could buy larger life insurance policies. In either of these cases, the government still would collect sizable amounts of revenue.

Our proposal also applies only to the very richest Americans, those most able to afford the tax (and absent effective taxation like this, most likely to create dynastic wealth). The earlier proposals to tax unrealized gains at death had much lower thresholds.

Of course, many still may resist, viscerally, so-called death taxes. But death taxes score high marks as tax policy, as Jerome Kurtz and Stanley S. Surrey summarized decades ago:

> The taxes are progressive according to wealth — a good measure of ability to pay. . . . Compared to other taxes, death taxes have few and minor effects on the allocation of resources. They are collected at relatively convenient times when funds are usually available to pay them. Moreover, they seem to have little impact on entrepreneurial drive or risk-taking.[65]

4. Potential revenue.

Critically, a tax on unrealized gains at death could collect sizable amounts of revenue, even with high thresholds. Under our proposal, $12.6 trillion (out of $13.4 trillion) of the unrealized gains (and the figure is likely to rise) of taxpayers with a net worth of more than $100 million, would be taxed at either a lower rate during life or a higher rate at death. Taxing the $12.6 trillion at the lower rate of 23.8 percent would result in $3 trillion of income tax receipts, while taxing that amount at the higher rate of 40.8 percent would generate more than $5 trillion (in 2025 dollars).[66] Payment of these new income taxes would reduce the size of the taxpayer's estate, and presumably, estate taxes paid later, by 40 percent, leaving $1.8 trillion to $3 trillion of net receipts.

The receipts in the first 10 years, the so-called "budget window," would be lower than the total eventual receipts. It is hard to estimate how much lower-taxed gain during life would be induced by the prospect of the higher tax rate at death. However, as noted earlier, the average age of our ultrawealthy population is 69, so we would expect virtually all of them to die within 30 years.

As a stylized example, we might consider how taxpayers with more than $100 million in assets might respond to an increase in tax rates on assets that are bequeathed. They have access to the best possible financial advice and, with their advanced age, are likely to have considered the disposition of their estates at their death. Many, if not most, might wish to leave the largest possible estate to their heirs, which would induce them to sell at least three years before death. In some cases, they might elect to mark their appreciated assets to market (that is, treating those assets as sold at their fair market value and repurchased at a new, higher cost basis). (Note: unlike the immediate repurchase of losing investments sold to reap tax-saving losses, this "wringing out" of capital gains is not subject to disqualifying wash-sale rules.)

What share of $12.6 trillion of unrealized gains would be subject to tax in a 10-year budget window? 25 percent? 50 percent? 75 percent? If we assume, conservatively, that 25 percent would be realized during life, the treasury would collect

[64] Mark Luscombe, "Historical Look at Estate and Gift Tax Rates," Wolters Kluwer (Mar. 9, 2022).

[65] Kurtz and Surrey, *supra* note 13, at 1367.

[66] We assume, conservatively, that asset prices increase at the same rate as inflation.

$750 billion [$12.6 * 0.25 * 0.238].[67] The group of wealthy taxpayers would then have $9.45 trillion dollars remaining [12.6 * 0.75]. If 5 percent of the group dies in the next 10 years, $473 billion of unrealized gains would be subject to a tax rate of 40.8 percent, generating $193 billion in revenue [9.45 * 0.05 * 0.408].[68] But income taxes that are paid, either during life or at death, would reduce an estate and estate taxes. So we reduce net revenue by $92 billion [(0.05 * 750 + 193) * 0.40]. In this stylized example, total revenue would be $851 billion [750 + 193 - 92].

The amount of revenue also depends on taxpayers' perceptions of the likelihood that the law would be repealed in their lifetimes. Affected taxpayers may assume that the law will be overturned before they die and may thus risk higher rates by continuing to hold unrealized gains well into old age.

V. Conclusion

Current tax law encourages wealthy investors to retain their appreciated assets throughout their lifetime to erase asset gains at death. It induces the rich to lock their capital into less productive investments, deprives our country of needed public revenue, and perpetuates dynastic wealth.

If the United States instead taxed the trillions of dollars of unrealized gains held by the wealthiest households, it could raise large sums of revenue, unlock capital for more productive uses, and stem the creation and maintenance of economic dynasties.

Designing a tax for these unrealized gains raises numerous challenges, starting with who should be subject to the tax. After comparing different approaches, we conclude that the best approach is taxing unrealized gains at death and at a higher rate than during life. This would encourage investors to sell (or mark-to-market) their assets well before they die. To minimize the financial and administrative burden of the new tax, we would apply the new tax only to the very richest Americans, since they hold a disproportionate share of unrealized gains and are best situated to pay the tax.

Appendix 1

Our Method to Extrapolate Existing Estimates

With the exception of our estimate of revenues from making borrowing a taxable event, all of our estimates use data from the 2022 Survey of Consumer Finances and the *Forbes* 400, extrapolated to 2025, as described in footnote 14.

For our 10-year estimate of revenue from shifting to carryover basis (from step-up), we start with the estimate found in option 51 of the Congressional Budget Office volume, "Options for Reducing the Deficit: 2025 to 2034."[69] Because the CBO revenue estimate applies to gains held by all families, we reduce that estimate to count only the share of unrealized gains of those with more than $100 million of assets, with a phase-in range to $200 million. That share is 21.2 percent.

For our 10-year estimate of revenue from making borrowing a taxable event, we start with the estimate of Fox and Liscow for the 2024-2033 period. Their 10-year estimate uses a 2024 estimate multiplied by 1 plus the historic annual growth rate raised to the 10th power. From their 2024 estimate and their 10-year estimate we calculate their historic annual growth rate as 6.26 percent. We obtain the 2025 estimate by applying that growth rate to their 2024 estimate. We then create a 10-year estimate by following their procedure, multiplying the 2025 value by 1.0626. Because their estimate already includes a phase-in between $100 million and $200 million, we did not adjust further for a phase-in.

For our 10-year estimate of mark-to-market accounting, we use the estimate provided by the Joint Committee on Taxation, as announced by Senate Finance Committee ranking member Ron

[67] When, in the early 2000s, Norway shifted from step-up to carryover for bequests, Norwegian taxpayers increased their capital gain realizations by 24 percent. Lucy Msall and Ole-Andreas Næss, "Never-Realized Capital Gains" (Jan. 21, 2025). If this estimate is accurate, and U.S. taxpayers react similarly, 24 percent may be a lower bound on the increase in realizations that would occur under our proposal. This is because Norwegian inheritors now must carry over the cost basis of their inherited assets, the total gains on which when and if sold are subject to the normal 28 percent capital gains tax. That's a (potential) 28 percentage point increase in the Norwegian taxation of inherited gains. In contrast, by abolishing stepped-up basis, deeming all bequeathed gains as realized, and charging ordinary tax rates on those gains, our proposal would increase the U.S. tax rate on inherited gains by 40.8 percent, a much bigger incentive to sell during life.

[68] We assume a relatively low number, 5 percent, to reflect a single person (usually a surviving spouse) or both members of a couple dying within the next 10 years. We also assume that the 5 percent who die are random across the population.

[69] CBO, *supra* note 51.

Wyden, D-Ore., with two adjustments. First, we adjust the window to match 2025-2034. This adjustment occurs in three parts. We use their estimates for the years 2027 through 2031. The JCT assumes a ramp-up in revenue for the first two years. We model that for the first two years — 2025 and 2026 — by using the same proportionate increase in revenue that the JCT uses. The last three years, 2032-2034, are projected by multiplying each successive year by the average of the annual growth rates of the JCT estimate from 2027 through 2031. Second, we lower the thresholds to match our analysis ($100 million of net worth with a phase-in range to $200 million). This results in substantially more revenue than Wyden's proposal, which the JCT estimated would generate $557 billion in revenue from 2022 through 2031.

We determined that the revenue raised from a lookback interest charge would be negligible based on an estimate for a lookback proposal that was similar to the one we examine. This other lookback proposal would have raised about $9 billion a year (after a transition period), according to Penn Wharton.[70] But this other proposal applied to all taxpayers, not just those with more than $100 million net worth, so we would need to reduce the revenue even further.

We used the estimate from the stylized example in this article for the proposal to tax unrealized gains at death at 40.8 percent.

Appendix 2

Constitutionality of Taxing Unrealized Gains

The threshold question is whether a tax is direct or indirect. The Constitution only references "direct taxes" without describing them, so direct and indirect taxes can only be defined as not being the other. The Constitution requires direct taxes to be apportioned among the states by population.[71] This means that a state rich in population but poor in whatever is being taxed would pay a disproportionate share of the total collected. By contrast, the Constitution mandates that "duties, imposts, and excises" be uniform throughout the states. That means the amount of revenue collected from each state does not depend on population but on the number and size of the transactions subject to the tax.[72]

As the Supreme Court observed in *Moore*, the apportionment requirement for direct taxes is "complicated and politically unpalatable," which has made them "difficult to enact."[73] And none have been enacted since the Civil War. So, whether a tax is viewed as direct or indirect determines its viability.

Distinguishing direct from indirect taxes has been a problem from the start. The Supreme Court recently offered this distinction: "Generally speaking, direct taxes are those taxes imposed on persons or property," while "indirect taxes" are taxes on "activities or transactions."[74]

After 18th- and 19th-century Supreme Court decisions conflicted on whether a tax on income was a direct tax,[75] the United States adopted the 16th Amendment to the Constitution, which provides: "Congress shall have power to lay and collect taxes on income from whatever source derived, without apportionment." So, whether or not taxes on income are direct, they are not required to be apportioned.

So where does that leave the proposals to tax the unrealized gains of property held by the superrich (those with more than $100 million in net assets)? Would the tax be direct on the property (and potentially subject to apportionment by state population)? And if direct, would the tax qualify as a tax on income, which the 16th Amendment authorizes without apportionment?

[70]Penn Wharton Budget Model, *supra* note 44.

[71]U.S. Const. Art. I, section 2.

[72]In *Moore*, the Supreme Court gave an example of apportionment for a direct tax:

> If Congress imposed a property tax on every American homeowner, the citizens of a State with five percent of the population would pay five percent of the total property tax even if the value of their combined property added up to only three percent of the total value of homes in the United States. To pay five percent, the tax rate on the citizens of that State would need to be substantially higher than the tax rate in the neighboring State with the same population but more valuable homes.

Moore, 602 U.S. at 582.

[73]*Id.*

[74]*Id.*

[75]*Compare Hylton v. United States*, 3 U.S. 171 (1796) (intimating that only head taxes and real estate taxes are direct) *with Pollock v. Farmers' Loan and Trust Co.*, 157 U.S. 429 (1895), and 158 U.S. 601 (1895) (a tax on income from any property, real or personal, equated to a tax on the property itself, which would be direct).

Recently, four justices of the Supreme Court, just one short of a majority, questioned the constitutionality of a tax on the appreciation of unsold property (during a taxpayer's life).[76] In *Moore*,[77] the plaintiffs challenged a one-time retroactive provision in the Tax Cuts and Jobs Act requiring investors to pay a tax on undistributed profits earned by American-controlled foreign corporations. The plaintiffs argued that the provision was unconstitutional because a tax on undistributed profits was a direct tax on property (their stock in a foreign corporation) and was not income within the meaning of the 16th Amendment.

The Court majority ruled against the plaintiffs, but on a narrow basis: The income that had been realized by the Moores' company was effectively realized by its owners as well; hence, the Moores' share of the business's undistributed profits could be taxed under the 16th Amendment. And the Court explicitly declined to rule on whether a "tax on appreciation" is a tax on income.[78]

However, four justices, in their minority opinions, were ready to rule that a tax on appreciated property is unconstitutional without apportionment (and that unrealized gains are not income). One justice said that unrealized gains do count as income, while the views on this topic of the remaining four justices are unknown. So the constitutionality of an annual tax on appreciation would be questionable.

However, based on prior precedent, a tax on unrealized gains *at death* would likely not be viewed as direct (and thus not subject to apportionment). It could be characterized as a tax on an activity — the transfer of property at death — not on the property per se. That is the long-standing rationale for today's estate tax, which also is a tax on the transfer of property at death.[79] So if the Supreme Court follows long-standing precedents, a tax on unrealized gains at death would be judged constitutional.

There is a similar argument that a law that treated borrowing as a realization of gain from appreciated property would not be a direct tax. That is, the tax could be considered on the act of borrowing, not on the property with unrealized gains.[80] In our view, this characterization is harder to make, but no controlling precedent exists.

Finally, some proposals to tax unrealized gains that are direct taxes still might qualify as taxes on income (and therefore not subject to apportionment). The proposals to carry over basis or to add lookback interest charges just increase the tax on income realized on a later sale, so the courts would likely treat them as taxes on income, authorized by the 16th Amendment.[81] ■

[76] Only four justices are needed for the Court to grant certiorari to hear a case, so these four justices could ensure that the Court hears a future tax case that raises alleged constitutional issues. *See* Leslie B. Samuels, "Some Preliminary Reflections on *Moore*," *Tax Notes Int'l*, July 29, 2024, p. 679.

[77] *Moore*, 602 U.S. 572.

[78] *Id.* at 584 n.2.

[79] *See New York Trust Co. v. Eisner*, 256 U.S. 345 (1921). *But see* Henry Lowenstein and Kathryn Kisska-Schulze, "A Historical Examination of the Federal Estate Tax," 27 *Wm. & Mary Bill Rts. J.* 123 (2018) (concluding that the estate tax is unconstitutional under a strict constructionist view).

[80] *See* Colin J. Heath, "Taxing Borrow in Buy/Borrow/Die," 97 *NYU L. Rev.* 717, 739 (2024) ("Framed as an excise on the borrowing transaction, a realization at borrowing rule would certainly survive constitutional scrutiny.").

[81] However, these taxes still might be objectionable if they apply only to taxpayers with net wealth exceeding a threshold amount, which, arguably, converts them into a wealth tax. Daniel Hemel, "A Wealth Tax Is a Good Idea — If We Had a Different Supreme Court," *The New York Times*, Oct. 26, 2021.