Published on *The National Law Review* https://natlawreview.com

The End of Capital Gains As We Know It? Wyden Releases Proposal Profoundly Changing How Capital Gains Are Taxed

Article By:

Mary Burke Baker

Daniel F. C. Crowley

Adam J. Tejeda

The plan would tax all capital gains as ordinary income; end deferral of capital gains tax for the wealthy

Senate Finance Committee Ranking Member Ron Wyden (D-OR) recently released a proposal, "Treat Wealth Like Wages," that would fundamentally change the way that capital gains are taxed. Aimed at reducing the disparate tax treatment of wages and capital gains, these are the highlights of the proposal:

- Capital gains would be taxed at ordinary income rates. Middle-class taxpayers would not pay more than under the current law, although it is unclear how that would be effectuated. C corporations are exempt from the proposed regime. The proposal would generally apply to all capital gains, including but not limited to business and personal, short-term and long-term, stocks, businesses, residences, collectibles and carried interest.
- Taxpayers with either $1 million in annual income or $10 million in assets would be required to pay an "as-you-go" tax on capital gains. The form of this tax would depend on whether the asset is a tradable or non-tradable asset:
    - Tradable assets would be subject to annual mark to market, i.e., any gains or losses that occurred on paper at the end of the year would be currently taxed at ordinary income rates. This category includes stocks, bonds, cryptocurrency and other readily tradable assets where the values are easily determined.
    - Non-tradable assets would be subject to a "look-back" tax upon disposition of the assets. The look-back tax would be in lieu of annual mark to market to account for the time value of money and will be in addition to tax on the gain at the time of disposition. Non-tradable assets include personal residences, businesses, family farms, ownership interests in partnerships and S corporations, and collectibles.

The proposal is based on two pillars of tax policy: deferral and rates. Sen. Wyden asserts that wage earners with ordinary income do not have the option to defer paying taxes on their income, so wealthy individuals with capital gains income should not have that option either. He further argues that capital gains should not be taxed at preferential rates compared to ordinary income.

The proposal would apply to individuals (including pass-through income), estates and trusts with either $1 million of income for the year or $10 million in assets in each of three consecutive years. Taxpayers can toggle between the $1 million of income and the $10 million in assets among the three years and still fall under the rules. Taxpayers failing to meet either criteria for three years in a row would no longer be subject to the proposed regime.

Some exceptions apply. The first $2 million of personal residence value, $5 million of family farm value, and $3 million of retirement portfolio value would not count toward the $10 million asset threshold. Once a taxpayer hits the $10 million threshold, amounts over $2 million (residences) and $5 million (farms) are subject to the look-back tax. While retirement assets over $3 million would count toward the $10 million, they would not be subject to the look-back tax. A mechanism would be established, perhaps in the form of a credit or deduction, so that middle-income taxpayers do not pay more using ordinary income rates than they currently pay using capital gains tax rates. Although not specified in the proposal, transition rules for assets acquired prior to the effective date of enactment are anticipated, as is a phase-in for the look-back tax once thresholds are reached.

There are many unanswered questions about which Senator Wyden and Committee staff are requesting comments, including the treatment of Opportunity Zone gains and losses, insurance products, like-kind exchanges, transition and phase-in rules, how the look-back tax will be structured, the treatment of pre-effective date capital assets, treatment of losses that cannot be absorbed in the current tax year (losses will be allowed to be marked to market, similar to gains), and general anti-abuse rules (including how to avoid gaming the regime by stuffing assets into a closely-held corporation).

Although there is much work to be done to flesh out the proposal and the prospects of enactment are low under the current Administration and Republican-controlled Senate, many Democratic presidential candidates have proposed or support increasing taxes on the wealthy as a mechanism to pay for other priorities. If Democrats were to sweep control of Washington in the 2020 elections, it is possible that some version or aspects of this proposal could gain momentum and be enacted into law, potentially through the budget reconciliation process, the same process that the Republican Congress used in 2017 to enact the Tax Cuts and Jobs Act.

National Law Review, Volume IX, Number 261