

Remarks by Assistant Secretary for Tax Policy Lily Batchelder for the D.C. Bar Association



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Remarks as prepared for delivery.

Thank you, Scott, for the kind introduction, and for inviting me to speak today. It is a privilege to be here.

The DC Bar is at the center of the tax world, and the insights you bring to tax legislation and regulations are unmatched.

Today, I want to talk about some of Treasury's tax policy priorities by highlighting some of our initiatives and proposals, while also looking ahead to both challenges and opportunities.

I trust many of you have looked through our Greenbook, and you probably noticed a theme, which is to ensure capital does not go untaxed. President Biden and Secretary Yellen are committed to taxing wealth like work, and the Office of Tax Policy has been busy developing plans centered around that goal.

Under current law, hard-working Americans have to pay tax on their wages and salaries as they earn them, while the ultra-rich can reap the rewards from investing their capital without ever paying a dime on their wealth as it accrues.

They can even enjoy access to their capital in multiple ways without paying taxes, including borrowing against their wealth.

You may have noticed news stories last week about a billionaire being able to borrow more than \$25 billion against stock he owed. This is definitely not something that most Americans can do, let alone avoid paying taxes in the process.

Indeed, the ultra-rich can increase their wealth by millions of dollars, delay paying taxes on those gains for decades, and if they hold on to their appreciated assets until death, the capital gains tax on their appreciation is forgiven forever, which ultimately benefits their wealthy heirs.

In part because of these tax planning opportunities, the Council of Economic Advisors recently estimated that that, between 2010 and 2018, America's 400 wealthiest households paid an average Federal individual income tax rate of only 8 percent on their income when you include unrealized gains on stock, real estate, and other assets.

Meanwhile, labor's share of the federal tax burden has increased dramatically. About 50 percent of federal taxes came from labor income in 1950; now that figure is around 85 percent. And that's true even though labor's share of the national income declined steadily over that period.

This trend has implications not only for the taxation of labor versus capital income, but also for aggregate income inequality.

Since capital income is disproportionately concentrated among wealthier taxpayers, tax preferences for capital very disproportionately benefit the rich.

And the disparities are stark: in 2022, the bottom 99 percent received 10 percent of their income from capital, while top 1 percent received 51 percent of their income from capital. Overall, the top 1 percent received 53 percent of all capital income.

Simply put, allowing the rich to escape taxation of their capital income prevents us from having a fair tax system.

It also denies the government revenues that could be used to help ensure economic mobility across the income distribution, through public investments in education, childcare, health care, training, and research.

Turning to how we propose to address this challenge, on the individual side, we propose increasing the income tax rates for those in the top bracket to 39.6 percent, and ending preferences, such as those for carried interest and like-kind real estate exchanges, that disproportionately benefit the wealthy and distort economic activity.

Our Budget also proposes taxing long-term capital gains and dividends at ordinary rates for those with taxable income over \$1 million.

In another important step towards evening out the tax treatment of labor and capital income, extremely large capital gains would be taxed upon gift or bequest.

This provision would only apply to the extent an individual's accrued gains on gifts and bequests exceeded \$5 million (or \$10 million per couple). And it would ensure that such massive capital gains do not escape taxation forever.

The Greenbook also addresses tax planning techniques that reduce Federal income and wealth transfer tax obligations through the use of Grantor Retained Annuity Trusts (GRATS) and generation-skipping transfers, which would help ensure that the wealthiest estates and their heirs pay their fair share.

Finally, the Greenbook takes a novel approach to one of the most vexing problems facing the income tax—the differential treatment of unrealized and realized gains.

This differential has long been referred to, first by Bill Andrews, as the “Achilles heel” of the income tax system—because of its major efficiency and equity costs.

Despite the fact that they clearly represent income, unrealized gains are difficult to tax because of understandable liquidity and valuation concerns, which a realization event generally solves.

Our proposed “billionaire’s” minimum income tax would take on this “Achilles heel” of the income tax, while also addressing these concerns.

Rather than waiting for a sale or transfer, it would collect prepayments of the tax ultimately due on extraordinarily large capital gains as those gains arise, but only when the taxpayer is sufficiently liquid and using straightforward and conservative valuation rules.

Just as the vast majority of Americans have to pay taxes on their income as they earn it, the super-rich would have to pay a minimum rate of tax as their income as it accumulates.

Specifically, the minimum income tax proposal would require the most well-off taxpayers--those with wealth greater than \$100 million--to pay tax at a rate of at least 20 percent of their income including unrealized gains.

This is of course far lower than the top ordinary rate or even the capital gains rate.

If a billionaire was already paying tax at a 20 percent rate on their full income as defined, they would pay no extra tax. But if they paid tax at that average 8 percent rate that I mentioned earlier, they would owe top-up payments over time that would gradually bring them up to the 20 percent minimum.

These top-up payments would be treated as prepayments of taxes. So when a taxpayer realized those gains, they would get credit for their prepayments, ensuring that they would never have to pay tax on over 20 percent tax on of their unrealized gains.

They would also get refunds for losses and charitable gifts to make sure they never have paid more than the long-term capital gains rate on their unrealized gains.

And this would ensure that charitable contributions would not be disincentivized by the proposal; in fact, charitable giving incentives would increase.

To address liquidity concerns, illiquid taxpayers could elect to defer paying the minimum tax on unrealized gains from non-tradeable assets until they were realized, subject to an interest charge, which would be capped at 10 percent of the unrealized gains.

This means taxpayers would never have to sell non-tradeable assets in order to pay the tax. They would be definition always have plenty of liquid assets.

And when they sold non-tradeable assets, their tax rate will be reasonable.

Meanwhile, to address valuation concerns, taxpayers would not have to obtain annual valuations of nontradeable assets.

Instead, the proposal would look at measurements of value that the taxpayer already has—such as adjusted basis, or valuations for investment, borrowing or financial statement purposes—and then increase those by a conservative interest rate.

I should also note that this proposal is limited to taxpayers who are already very well-advised.

The net result of these capital income proposals is that income from wealth would be taxed more like income from work, especially for the most fortunate among us. The minimum income tax would only affect about 1 in 10,000 taxpayers, and more than one half of the revenue would come from billionaires.

These proposals would not just make the tax code fairer, they would also reduce the “lock-in” effect—or the incentive to hold on to underperforming assets purely for tax reasons.

This incentive is created by stepped-up basis for bequests and the lower effective tax rate on unrealized gains.

And addressing it would improve economic efficiency and capital allocation.

Finally, these proposals would raise on the order of \$600 billion over ten years, which could be used to invest in our economy and people.

So far, I have focused on individual income taxation. But another key component of taxing capital is taxing corporations, since capital and shareholders bear the lion’s share of the corporate tax burden.

Our Greenbook proposes raising the corporate tax rate from a historically low rate of 21 percent to a more balanced rate of 28 percent, which is still far below the rate in place from

World War II to 2017.

It also assumes within the baseline the important international tax reforms the House passed last year, which would strengthen and reform GILTI and BEAT, including by applying GILTI on a per country basis.

These reforms would align our law with the global tax deal, which I will discuss, and fulfill our commitments under it.

But just as importantly, they would dramatically reduce profit shifting incentives, for both US multinationals, and foreign multinationals operating in the US. These profit shifting incentives inefficiently inhibit domestic productivity.

The BEAT reforms would also serve as a major incentive for countries to adopt minimum taxes on the foreign earnings of their multinationals.

Meanwhile, the revenue raised could be used to finance transformative investments in infrastructure, R&D, green energy, and the well-being and education of Americans.

But in recent years, reviving the corporate tax seemed like a hopeless cause.

This was because of an outdated international tax system that rewarded companies that made investments and shifted real economic activities abroad purely for tax-motivated reasons. And because of a race to the bottom among nations for who could have the lowest corporate tax rate. This tax competition led to the OECD average corporate tax rate declining from 40 percent forty years ago, to just 23 percent today.

One of the biggest accomplishments of this Administration to date has been the global agreement to stabilize the international tax landscape. This agreement removes these tax distortions in a way that benefits the American people and US businesses.

In a remarkable testimony to multilateralism, 137 of 141 jurisdictions in the OECD Inclusive Framework have agreed to a global minimum tax, and to partially reallocating taxing rights from countries where companies are headquartered to those where they sell goods and services.

This includes all G20 and EU countries, representing nearly 95 percent of the world's GDP.

You may have noticed that in this year's Greenbook, we proposed a slightly different approach to addressing base erosion and enforcing the global minimum tax, called a UTPR.

Treasury and the Administration fully support the BEAT reforms in the House-passed bill, and the UTPR is really an alternative model for accomplishing the same objective. Both create powerful incentives for other countries to join and comply with the new global regime, and both further the goals of the global agreement.

The Greenbook's UTPR proposal also includes our commitment to working with Congress to ensure that US companies continue to benefit from incentives that help grow the economy and generate jobs.

My team has worked with the OECD to clarify the treatment of general business credits under the minimum tax in the Commentary to the Model Rules and in recent OECD public statements.

We are confident that the value of many of our general business credits is preserved under the OECD rules, and we have established a process with the OECD for working towards additional clarifications.

For example, we have heard concerns about the potential impact of other countries' UTPRs from some taxpayers that invest in projects that give rise to the Low-Income Housing Tax Credit, certain renewable energy credits, and the New Markets Tax Credit.

But because of the way those investments are structured and accounted for, the income or loss and the income tax consequences of those investments typically will be excluded from the effective tax rate calculation, so those credits generally should not be impacted by UTPRs.

I think it is important to remember that at the end of the day, most countries really want this system to work, to stop the race to the bottom, but also to bring on board the biggest headquarters jurisdiction on earth.

But let me further discuss what those goals of the global agreement are.

Currently, the United States is the only country with a formal minimum tax on foreign earnings. The global minimum tax rate is zero percent.

To be sure, some countries have anti-abuse regimes that limit profit shifting at the margins. But many of these regimes are leaky and poorly coordinated.

Pillar Two of the agreement sets a floor so that multinational corporations, whether headquartered in the US or abroad, will pay taxes on their earnings in each jurisdiction in which they operate at a rate of at least 15 percent.

That means that all 137 countries that are part of the agreement have agreed to impose this country-by-country minimum tax on the foreign earnings of all of their resident multinationals.

But that is not all. In a new step for international tax law, the agreement includes a strong enforcement mechanism, which ensures that countries honor this commitment, while heavily incentivizing non-signatory countries to join the common framework.

Specifically, these enforcement rules allow agreeing countries to impose top-up taxes on companies operating in their jurisdiction if the corporate group's effective tax rate falls below the 15 percent minimum in any jurisdiction.

And that is true even if the corporate group is not headquartered in that country.

So, essentially, if a country does not enact the country-by-country minimum tax on its resident multinationals, other countries will apply the minimum tax to those multinationals via their subsidiaries, and soak up all the revenue that that the non-implementing country could have collected.

This means there is little or no incentive for a country to hold out from implementing the global agreement once other countries begin to enforce it.

I want to emphasize that this agreement is not a zero-sum game.

Workers will benefit significantly because it will ensure that the owners of capital fairly share the burden of financing government investments.

But it will also bring important benefits to US businesses.

Small businesses will benefit because they will no longer face a competitive disadvantage compared to large multinationals that can shift profits on paper to low-tax jurisdictions, while they pay the full US rate.

And our largest corporations will benefit too.

No longer will they be based in the only country that formally requires them to pay a minimum tax on their foreign earnings.

Shifting to Pillar One of the global tax deal, it has similar benefits for US business by stabilizing a system that has frankly been upended.

Over the last 15 years, the current system for allocating taxing rights has lost the support of many countries.

It ignores the realities of doing business in a modern world, and instead demands physical presence for taxing rights to be triggered.

This has led to longstanding complaints by countries that are primarily market economies rather than headquarters jurisdictions.

More recently, these objections were joined by complaints from developed economies, especially in Europe, that historically supported the current system, but were frustrated by the ability of so-called digital giants to escape taxes in their jurisdictions.

Over the past few years, these political pressures abroad began creating a chaotic array of digital services taxes and other unilateral measures that discriminated against US businesses. They also threatened them with multiple layers of taxation, and escalated tax-related trade tension, which could harm economic growth.

Moreover, as more sectors digitized and countries got more creative, these measures threatened to expand beyond the digital sector.

Pillar One promises to restabilize the system with a new approach that would be sustainable and will put an end to unilateral, discriminatory measures.

Importantly, the agreement protects US interests.

As one of the largest market economies in the world, we stand to benefit from Pillar One's partial reallocation of taxing rights to market jurisdictions.

Our companies will also benefit from the increased tax certainty it will create. They will be able to plan for the future and invest their capital based on economic and not tax considerations.

No longer will they face unilateral tax measures that threaten them with multiple layers of taxation. And no longer will they face the threat of escalating trade wars and tariff retaliations, which are bad for US business.

The final subject I want to touch on is the importance of ensuring the IRS has the resources it needs to serve the American people and enforce the tax laws.

Because even if we write policy proposals into law that promise to make the tax system fairer, that promise is empty if the IRS remains outgunned and under-resourced.

It is absolutely first order for tax reform efforts to ensure that the IRS has the tools that it needs in place.

I have to start by acknowledging that this filing season has been a challenging one. But it is important for us to recognize that the challenges the IRS is facing stem from two things:

First, a global pandemic that forced the IRS to adjust staff levels and operations at the same time that it was providing critical support to families, without the resources it needed to do either.

And second, systematic underfunding for more than a decade.

The truth is that the IRS's challenges date back much further than the pandemic. The last few years did not have to be as difficult for American taxpayers as they have been.

Chronic underfunding has decimated the agency, making its work herculean in normal times. And the past couple years have not been normal.

Over the past decade, the IRS budget has been cut by nearly 20 percent in real terms.

As a result, its workforce is the same size as it was in 1970, even though the US population has grown by 60 percent since then, and the economy is far more complex.

And the agency's technology is archaic, with some processing technology dating back to the 1960s.

So much of its work that could be efficiently automated—like processing paper returns—is still being done manually: Agents transcribe information from these forms by hand.

This is because the IRS does not have the resources to invest in a long-overdue and much-needed overhaul of its technological ecosystem.

The result of the pandemic and this chronic underfunding is an IRS that hasn't had the capacity to serve taxpayers the way they deserve this filing season.

For example, in the first half of the last year, the IRS received nearly 200 million calls—about triple the historic norm. Because it had fewer than 15,000 customer service reps, that translated to roughly one person per 13,000 calls.

The Administration has made overhauling the IRS a priority by pushing to secure adequate funding at every turn, including proposing a mandatory, stable funding stream of \$80 billion over the course of the next decade.

This funding would allow the IRS to enter the 21st century with a more robust workforce and modern technology, finally allowing it to adequately serve the American public.

It would also bolster the IRS's capacity to meaningfully attack the tax gap, by pursuing high-end evaders who accrue income in increasingly opaque ways.

Training personnel to effectively audit these high-end evaders takes years, which is why multi-year funding is so critical.

But I also want to take a moment to acknowledge all the IRS has done amidst these resource constraints.

Despite a lack of resources, the IRS has managed to provide extraordinary support to families in need over the course of the pandemic, including three rounds of over 150 million stimulus checks and the distribution of millions of advance payments of the Child Tax Credit, all for the first time.

The 2021 CTC reached a record nearly 40 million families with 65 million children, and the EITC was tripled for about 17 million workers without children.

The IRS delivered these critical benefits, which is a remarkable accomplishment.

In addition, each filing season, the IRS receives and processes about 160 million returns from individuals and nearly 50 million from businesses, collecting 96 percent of the total revenue of the federal government.

This filing season, IRS and Treasury have been focused on doing all we can to make the tax filing process less painful.

For example, we relaunched ChildTaxCredit.gov, which now includes several features that help simplify tax filing, including directing taxpayers to the best free filing options, and helping them determine their eligibility for remaining credits.

The IRS has also increased the availability of customer callback technology, which is now available for up to 70 percent of the types of calls that they receive.

Nothing will substitute for funding the IRS adequately and stably so that it can serve taxpayers in the way they deserve. But the IRS workforce has done extraordinary work with the resources they have.

In closing, I am hopeful that many of the Biden Administration's top priorities will ultimately be enacted, including investing in the IRS and strengthening the ways in which we tax capital.

The revenue these proposals would bring in would transform lives, by funding investments in our children and our communities, initiatives to combat climate change, and supporting

broadly shared economic growth.

But especially before an audience of distinguished tax lawyers, I do want to pause before I end to discuss the importance of tax regulations and other administrative guidance.

As you all know, statutory text can only specify so much, which in many cases requires Treasury and the IRS to issue regulations to implement, interpret, and clarify the law.

Last week, Treasury and IRS issued Notice 2022-21, which invites the public to submit suggestions for inclusion in the 2022-2023 Priority Guidance Plan. Those submissions are due by June 3.

I know many of you have clients with items they would like added to the plan and we welcome and encourage those submissions.

But I would also ask you to put on your hat as a private citizen who is also a tax expert and ask yourself what regulatory projects you think would most effectively improve tax administration and make the tax code fairer? What are we not thinking about that we should be? We would genuinely appreciate your ideas.

Thank you very much for giving me the opportunity to talk to you today, and I look forward to working together to improve our tax system going forward.