Joe Biden Wants to "Tax Income that You Don't Have"

Description

USA: Joe Biden wants to tax unrealized capital gains, and some neoliberal economists think it is a good idea.

Let's take a look and see what we think.

A capital gain is an increase in the price of something since you purchased it. It could be a stock, a bond, a house, artwork, gold, silver, anything for which there is a market. An unrealized capital gain is a paper gain based on the day's price. It is not income and it is not wealth until it is realized. You realize it by selling the item, thereby having the money in your possession. An unrealized capital gain is a *potential* possession.

So what does it mean to tax income you have not received?

Suppose you purchase stock at the beginning of the year and it rises in value by year end. That rise is an unrealized capital gain. You pay the tax on the unrealized gain, and then in the new year the stock market falls, wiping out the taxed gain.

The tax you paid eats into your original investment. You have experienced a wealth confiscation.

Most economists understand that there is no such thing as a capital gain on stocks or homes.

If you sell your stock or home, the replacement cost is the sale proceeds. If the stock or home has increased in price since you purchased it, you have to pay a tax on the sale proceeds. (You get an exemption on your home gain up to a certain amount.) Consequently, you cannot replace the stock or home with your sales proceeds net of tax. So what did you gain? You lost.

What would happen, for example, to the stock market if unrealized gains are taxed? There would be increased volatility. People would tend to realize their gains as they occurred so as to avoid taxed gains being wiped out by a market correction.

It is also likely that net new investment would decline. Capital gains are a measure of rising profitability. The capital gain satisfies the investor in the company, leaving him content with a low dividend, thus freeing most of the earnings for debt-free investment.

If unrealized capital gains are taxed, the person has to find the money elsewhere to pay the tax, as he hasn't realized the taxed gain. He has to sell some other asset, cut back his living standard, or borrow the money to pay the tax. The cost and inconvenience of this would lead to pressure on companies to pay out more or all of their earnings in dividends in order for investors to avoid paying taxes on gains that might turn out not to be there. This would reduce the funds the company has in retained earnings for investment, and force the company to borrow, that is, to indebt itself to maintain the same level of investment.

Consider also the effect of taxing unrealized capital gains on quarterly estimated tax payments. The taxpayer doesn't know if a stock market boom is going to push up equity prices and leave him with a large unrealized gain at the end of the year or experience a correction, so how does he estimate the required quarterly payments for non-W-2 income?

Suppose the taxation of unrealized capital gains applies to your home. In a rising housing market, where do you get the money to pay the tax on the rise in your home value? Do you borrow it, sell your car, cut back your living standard? Do you do this year after year in rising housing markets?

The same question arises for an art dealer or collector.

As you can see, taxing unrealized capital gains is a nonsensical idea.

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***by Dr. Paul Craig Roberts** writes on his blog site, PCR Institute for Political Economy, where this article was originally published. He is a regular contributor to Global Research.*

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