# What Trump’s Tax Returns Reveal

By Eugene Steuerle *Wed, Oct 28, 2020*

*Everyone loves a tax cut, and low interest rates appear to boost the economy, but they don't necessarily represent the tide that lifts all boats. Our guest columnist suggests that they can also promote inequality and inefficient investment.*

*The New York Times* account of President Trump’s tax returns reveals far more than his personal ability to avoid taxes. They show how the tax law can make it easy for the very wealthy to avoid taxation. And they reveal more than deficiencies in the tax law.

Bankruptcy laws allow wealthy investors to shift losses to others even while they retain gains elsewhere, bank lending practices favor the rich, and for the last three decades monetary has subsidized highly leveraged wealthy investors by driving borrowing costs ever lower and creating a huge wealth bubble that has saved even the most inefficient of investors.

Whether the president engaged in questionable or even illegal tax practices is only a small part of this story. But by focusing on his personal behavior, Congress may miss an opportunity to address the broader issues of fairness and equity and economic growth. Poor tax and economic policy can spur inefficient investment and concentrate opportunity on too few people.

One way the very rich avoid tax is through the discretionary nature of the individual income tax for investors. That is, the income from appreciated property (capital gains income) is not included in taxable income until the underlying asset is sold, a discretionary step taken by the investor.

In the early 1980s I calculated that less than one-third of the net income from capital showed up on tax returns. Studies comparing income declared on individual income tax returns with wealth reported in estate tax returns implied that taxpayers reported a rate of return often hovering around two percent, when the value of stocks and other assets rose by an average of around 10% per year. Close to one-third of wealthy people in each of the years examined declared a return on their income tax returns of less than one percent on their wealth.

While owners of corporations often do indirectly pay corporate income tax, large real estate investors typically use pass-through business and have long been close to exempt from both corporate and individual taxation. In the heyday of the tax shelter era of the 1980s, when real estate investors were making money while shielding other income with huge losses, members of the Senate Finance Committee wondered aloud whether Treasury would collect more revenue if the tax law simply exempted the investments from tax.

Further, if property is held until death, no income tax ever is owed on any accrued but unrealized gains. While gains can be deferred or excluded from tax at death, property owners can immediately deduct almost all expenses on their tax returns.

Interest costs are among the most important of those deductible costs, and the nominal interest costs written off are often a multiple of the real costs of borrowing. For example, if annual inflation is two percent and annual borrowing costs are four percent, the taxpayer deducts twice the real expense of the borrowing. The most highly leveraged investors receive the most benefits.

Investors in real estate can also take advantage of "like-kind" exchanges that allow them to swap real estate properties with another owner and defer the recognition of any capital gains income from the investment.

In this "Heads-I-Win, Tails-You-Lose" world, owners can declare bankruptcy of one company that is performing poorly while maintaining ownership of others that may be thriving. Earn $5 million on an investment in one company, lose $6 million in another; declare company bankruptcy in the second case, and the owner can come out ahead, while others bear the cost.

Bank lending practices, such as the Deutsche Bank loans to Trump, provide a third source of protection. Employees and officers of large financial institutions can make big money even for bad investments. They can earn promotions and bonuses by boosting the institution's cash flow, at least until everything blows up. And, of course, those bonuses and promotions usually can't be recaptured.

Finally, by creating real interest rates on short term debt that are close to zero, monetary policy can make the real cost of borrowing also close to zero or even negative after the taxpayer deducts nominal interest costs in excess or real interest payments. As one result, the ratio of household wealth to income rose remarkably from the early 1990s to today, generating at least an additional $25 trillion of nominal wealth over and above a normal growth rate. Recent efforts by the Federal Reserve to buy up all sorts of debt to keep the financial system functioning has further protected wealthholders even in the midst of the current COVID-19 crisis.

As noted above, all these policies have contributed significantly to increases in wealth inequality while they protected even the most inefficient investors. Trump’s tax returns may be just the tip of the iceberg, only one piece of visible evidence on a set of economic policies that may continue to lead to years of sluggish growth.

*This column originally appeared on TaxVox on October 19, 2020.*