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BUY, BORROW, DIE: HOW RICH LIVE OFF THEIR PAPER WEALTH AND AVOID PAYING TAXES AND WHY WE LET THEM DO IT?

Agnė Smagurauskaitė, Gabrielė Šarauskaitė

Vilnius University Faculty of Law
5th-year Finance and Tax specialization Law students
Saulėtekio av. 9, I block, 10222 Vilnius
Email addresses: agne.smagurauskaite@tf.stud.vu.lt;gabriele.šarauskaite@tf.stud.vu.lt
Academic and practical supervisor of the paper lecturer PhD. Povilas Gruodis
Email address: povilas@pentalex.lt

Summary. *In 2021, there are reportedly 2,755 billionaires on Earth, with an estimated total net worth of $13.1 trillion. Every year the newspaper Forbes conducts the list of World Billionaires, but we need to acknowledge that, not all billionaires and their wealth gets reported. Usually, the net worth is reported by calculating the number of stocks with the number of shares that the person owns. We take into consideration that the number we see in the newspaper exists only on paper, but the amount of money in the bank account of Billionaire does, not reflect that kind of wealth in any shape and form.*

Paper wealth differs from "real" or actual wealth, which is the value of the physical assets that are at the disposal of an individual or company. Many individuals and corporations fall victim to the paper wealth trap. On paper, it looks as though the assets logged are worth a certain amount, but the real assets in hand do not add up to the same. In order to assess, the real wealth individual has to realize the asset in the market by selling the asset mentioned below. If the taxpayer sells these assets, it has accumulated capital gains, then the taxpayer is subject to capital gains taxes.
By using the tax planning strategy "Buy, Borrow, and Die" the wealthy individual avoids paying the capital gain tax on the assets that they have. This principle suggests buying and holding assets as they appreciate tax-free, as well borrow using the assets as leverage and using debt to reduce or eliminate income and estate taxes, and maximize aftertax wealth accumulation, as well after the taxpayer pass away the heirs, sell the whole wealth is tax-free, and the debt is paid with the tax-free proceeds.

Keywords: *tax avoidance, taxation, investment, tax strategy.*

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Santrauka. *Remiantis 2021 m. duomenimis žemėje yra 2755 milijardieriai, kurių bendra grynoji vertė viršija 13,1 trilijono JAV dolerių. Žurnalas „Forbes“ kasmet skelbia pasaulinį milijardierių sąrašą, tačiau turime pripažinti, kad ne visi milijardieriai ir jų turtas lieka dokumentuotas. Paprastai grynoji turto vertė apskaičiuojama asmeniui priklausančių akcijų skaičių padauginus su kapitalo rinkose pateikiamos akcijos kaina. Matydami grynąją vertę, neretai pamirštame, kad tokia vertė egzistuoja tik popieriuje a, ir niekaip neatsispindi banko sąskaitoje.*

Popierinis turtas skiriasi nuo „realaus“ ar faktinio turto, kuris yra fiziniame pavidale ir priklauso fiziniam asmeniui ar įmonei. Daugelis asmenų ir korporacijų tampa popierinio turto spąstų aukomis. Popieriuje turto vertė, yra tam tikros sumos, tačiau realybėje nėra tas pats. Norint gauti realią turto vertę, asmuo turi realizuoti turtą rinkoje, o realizuojant susikaupęs kapitalo prieaugis apmokestinamas.

Naudodami „Buy, Borrow and Die“ mokesčių planavimo strategiją, turtingi asmenys išvengia mokėti mokesčius dėl atsirandančio kapitalo prieaugio. Remiantis šiuo principu, rekomenduojama turimą kapitalą laikyti kiek įmanoma ilgiau, taip pat naudojant skolą, kaip galimybę susimažinti pajamas, maksimalizuoti kapitalo prieaugį, ir jį palikti savo paveldėtojams.

Raktiniai žodžiai: *mokesčių vengimas, apmokestinimas, mokesčių planavimas.*

Introduction

This article primarily focuses on the concept of tax planning. As well, it analyzes the tax planning strategy Buy, Borrow, and Die, and how the high-net-worth individuals are using that tax system to their advantage.

The article covers the problems related to the generation of wealth, tax justice, and the structures of the tax systems. In this article we focus our attention on the unrealized capital gains, and why the governments made the decisions not to tax them.

The main purpose of this article – is to get familiar with the tax planning concept of Buy, Borrow, Die, determine the definition, analyze existing tax regulation, and determine the ways how the governments can deal with that kind of tax planning.

In order to write this article were used several academic righting methods including legal document analysis, that let readers get familiar with existing tax regulations, as a well descriptive method, that they can get familiar with the concept of „Buy, Borrow, Die” and analytical method was used to form the opinion about this phenomenon and give more perspective clarity.

The concept of “buy, borrow, and die”

1. Buy. The problem with capital gains

More than two decades ago USC Gould School of Law professor Ed McCaffery came up with the concept of “Buy, Borrow and Die” to explain how the rich use the tax system to their advantage (Kredell, 2021). This tax strategy is a perfectly legal way to avoid paying taxes, without being seen as greedy or without causing any reputational damage. “Buy, Borrow and Die” is not a relevantly new concept in tax planning, this strategy existed from the creation of the modern tax systems. So, let‘s dive deeper into this tax phenomenon.

It is important to understand that the majority of the word wealth is tied to unrealized capital gains from the assets such as shares, bonds, and other alternative investments such as Cryptocurrencies, that tend to rise in value each year, whether that increase was paid out in cash or not. From the tax policy point of view, unrealized capital gains are not referred to as taxable income, and the assets holders are not obligated to report and to pay taxes on unrealized wealth.

The governments around the world have decided that accumulated wealth becomes taxable income from the moment when that wealth was realized. To understand this tax planning concept is it critical to know how the capital gains form.

When the nominal value of assets rises above the price paid its owner, there is a capital gain. The increase in value of the asset is subject to capital gains taxation when the asset is sold (Davies, D. G.,1986, pp. 91–118). It is hard to value assets before they are sold, especially those who fluctuate in value or do not have a comparison in the market (Davies, D. G.,1986, p. 91–118).

A more precise determination of a capital gain (or loss) involves the difference between the amount realized, which is the gross amount received for the sale of property fewer commissions and other selling expenses, and the adjusted basis. The latter normally includes the original cost of property augmented by improvements but adjusted downward for depreciation (Davies, D. G.,1986, p. 91–118). Capital gains are generated in several ways. Assets can fluctuate in value if there are changes in the traditional factors that determine the level of demand. Changes in income, population, the prices of related products and services, the distribution of income, and tastes or preferences of individuals can affect the future earnings of an asset and thus its present value. Factors that influence supply can also cause the value of capital assets to rise and fall. Changes in technology, the quantity and quality of the labor force, and the discovery of natural resources can generate capital gains that are subject to taxation (Davies, D. G.,1986, p. 91–118). An asset that has risen in value one year may go down in value the next. This approach implies that assets should be revalued constantly, otherwise unrealized gains could accrue over several years.

The objection to this procedure is that, in the absence of exchange in the market, the cost of determining value is prohibitive. As a result, evaluation of the magnitude of capital gains occurs in practice only when an asset is sold (Davies, D. G.,1986, p. 91–118).

That creates several serious problems are associated with the taxation of capital gains. These include the bunching of capital gains in one particular year, the existence and impact of inflation, the estimation of revenue, and the effects on economic efficiency and growth. Taxing gains in asset values, which reflect only a general increase in prices when there are robust inflationary pressures, have deleterious effects on the economy as well as on individual owners. Indeed, altering tax and accounting rules to account for inflation represents the most fundamental tax problem affecting capital formation today (Feldstein 1979, p. 55).

Once you understand how the unrealized capital gains work, and why the governments decided not to tax them, the next step is simple, you just need to buy the assets, that in the near future will create unrealized capital gains, like shares, bonds, and other investments. It is important to remember, if you keep your investments for the long term, you do not have to pay taxes, until you sell the asset and recognize accumulated gain.

2. Borrow. How to use debt to your advantage

To the majority of people, debt is often associated with difficult financial situations and poor financial decisions. Ordinary people try to avoid it at any cost. But for the many wealthy individuals, debt is just another mechanism to build wealth and gain more assets, by using the existing financial system to their advantage. They use debt rather than equity to finance investment. It is caused by interest payments being deductible for the personal or corporate income tax while equity payments are not (Heckemeyer, J.H. & de Mooij, R.A., 2017).

Deductibility of interest also serves as a shield against income taxes, thereby alleviating the tax distortion to the level of real investment. As well, the deductibility of interest allows to shift of some of the cost of debt finance onto other taxpayers (Sorensen, P. B. 2017). With interest payments being deductible, there is an incentive to issue debt until the expected tax benefit is offset. Taxation can distort other margins of financial choice too – such as whether and when to realize capital gains or losses – and some of the issues this creates are also considered (Keen, M., Klemm, A., and Perry, V. 2010).

Debt financing is treated favourably under tax law. Deductions lower the overall cost of financing the investments, and the investor use this leverage to, pay back the interest and loan, using only proceeds from the assets bought, with minimal need for using equity. This strategy helps investors to keep borrowing to buy assets for the

rest of their life as long as their assets appreciate. That is why debt makes a favourable financial instrument to build wealth.

One of the few advantages for wealthy individuals is that the government does not require taxes on loans, only on interest payments. That is why in need of capital is better to borrow, sell the appreciated assets, trigger the taxable event and pay taxes on capital gains.

Instead of selling, the Buy, Borrow, Die approach involves taking out a loan from a bank, using your assets as collateral. These types of loans generally come with low interest rates because the risk to the bank is also very low, and in these kinds of assets can be easily converted into ready cash without affecting its market price, in the event of investor's insolvency.

While you will have to pay the interest on the loan, that interest is much lower than what you would be paying in capital gains taxes. And since you're not selling your assets, hold on to them and allow them to continue to grow and compound. McCaffery is one of many interviews stated that and unlike the wages and salary most people use to pay for living expenses, the borrowing is not taxed, so they face a relatively low tax bill. It is not wise to sell these appreciating assets to get cash because that will trigger a taxable event and the goal here is to stay rich and pay less or no taxes altogether.

As well, wealthy people can use debt restructuring, to find the better interest rate, and make loan repayment more flexible. Additionally, a taxpayer can deduct an amount for costs associated with rescheduling or restructuring certain debt obligations where the rescheduling or restructuring provides for the modification of the terms or conditions of the debt obligation, or the conversion or substitution of the debt (Steeves, C. J., and Walker, K. 2021).

A low borrowing rate encourages greater borrowing for consumption smoothing purposes and by substituting for precautionary wealth holdings that households would otherwise accumulate to smooth transitory income shocks. But a low borrowing rate can also increase liquid wealth: if the leverage premium is positive, borrowing to invest in equity enables the household to increase wealth over time (Davis, S.J., Kubler, F. & Willen, P., 2006.)

Since debt is almost always cheaper than equity the wealthy individual tries to maximize the ownership of assets, by using the debt, and that way reduces the cost associated with obtaining equity. After the loan is fully played the assets automatically become equity, and they can be used as collateral to obtain more assets. If this cycle continues, more equity and more wealth are obtained, without triggering the tax event paying and eventually without paying any taxes.

3. Die. The problems related to the generational wealth and inheritance tax

Wealth transfers between generations can have implications for both intergenerational and intragenerational justice. Such transfers may replicate or strengthen wealth inequalities and thus an unequal distribution of wealth may endure from one generation to the next. There are various positions as to whether such unequal distribution of wealth is permissible (Stößel, J., Schneidereit J., & Stockburger, S., 2020.)

Recent research in the field of intergenerational justice has highlighted the moral significance of inequality among retirees and, in particular, how this wealth gap is compounded by the added effect of gifts and inheritances on top of unequal earnings during working age. It is argued that the economic consequences of inheritance are not a matter of how much people leave, but rather what people (expect to) receive. Intergenerational wealth transfers can have important effects earlier on in life, especially when it comes to retirement planning (Brenner L., & Stolper, A., O., 2020). Given the concentration of capital among high wealth households, failure to tax capital income and wealth transferred across generations also raises questions of fairness, as it could substantially alter the progressivity of the tax schedule (Avery, R. B.; Grodzicki, D. J.; Moore, K. B. 2015).

Taxation of intergenerational transfers of wealth represents a core topic, as inheritances play a pivotal economic and societal role in relation to the concentration of wealth within countries (Stark, J.A. and Kirchler, E. 2017). Inheritance taxes represent financial obligations that are part of the legal regime governing the transfer of assets to family heirs following the passing of a family member (Ortiz, M. et al., 2021).

Inheritance taxes include:

- individual taxation of beneficiaries and;
- estate tax (i.e., tax on the transfer of the estate of a deceased person) ((Ortiz, M. et al., 2021).

Estate and inheritance taxes are broadly similar because both are generally triggered by death. Estate taxes are levied on the net value of property owned by a deceased person on the date of their death. In contrast, inheritance taxes are levied on the recipients of the property. Both of these taxes are generally paired with some kind of gift tax so that they cannot be avoided by simply transferring the property prior to death (Cole, A., 2015).

Inheritances compound over generations, one reason societies often choose to tax them as a way to combat rising inequality and level the playing field. Our tax system has always been one of our most potent tools for expressing and acting upon our values. But in this area, it is failing and only getting worse (Batchelder, L., 2020). Inheritance tax design allows for the application of different tax rates and allowances linked to certain characteristics of the beneficiaries (Gross, C., Lorek, K. & Richter,

F., 2016). Inheritance tax rates vary considerably across countries (Ortiz, M. et al., 2021). According to similarities existing across countries in the general concept of the tax, we can find differences concerning tax rates and exemptions. In many countries, even when tax rates are progressive, the family principle is still partly considered in the design of inheritance taxation, i.e. close family members are granted preferential treatment.

Differences across countries become also visible when we look at the inheritance taxes as a percentage of total taxation in selected European countries in figure the share of inheritance taxes ranges between 0 and 2% of total taxation. The highest shares can be found in France and the Netherlands, and the lowest in Italy and Denmark (Jestl, S., 2021).

The tax codes allow an individual to avoid paying tax on capital gains by holding assets until death. This may make individuals less likely to sell some assets (such as businesses) during their lifetime (the lock-in effect) and prevent the desirable transfer of assets to more productive owners (Avery, R. B.; Grodzicki, D. J.; Moore, K. B. 2015).

The super-rich holds their assets that grow in value until they die, neither they nor their heirs ever pay taxes on the unrealized capital gains (Miller, J., 2021). When appreciated assets are passed on to heirs, their tax basis is set at the value at death, consequently, taxes on the gains prior to death are eliminated (Avery, R. B.; Grodzicki, D. J.; Moore, K. B. 2015). The tax "basis" of assets becomes their value at the time of death, instead of their value at the time when the assets were purchased (Miller, J., 2021). An estate tax is separate from capital gains. Estate tax and capital gains rates can further distort household decisions regarding when to realize gains from the capital.

If heirs decide to sell all accumulated assets and to settle all the diseased debts, the unrealized gains are washed away, the creditors are paid, and the wealth that was collected true the lifetime is transferred to the next generation without minimal taxation from the government and cycle of the Buy, Borrow, Die all start over again in the next generation.

The modern tax systems reward accumulated wealth and benefit intergenerational transmission of fortune. It creates dynasties the main goal of the trap and maintains wealth true several generations.

Taxing wealth gains, including unrealized as well as realized capital gains, is the key to creating a tax code that adheres to the ability to pay and requires the ultra-wealthy to pay their fair share of taxes. And unlike other measures needed to implement an income tax based on the comprehensive Haig-Simons definition, taxing unrealized capital gains yearly is administratively feasible (Miller, J., 2021.)

That creates a lot of difficulties not only from the tax policy side but as well from the tax administrators. Unrealized capital gains are hard to determine value before it is realized, and that creates another set of problems.

The key question that legislators around the world must address, is how to limit generational wealth, change the behaviours of taxpayers and incentivize the transfer of assets to more productive owners, without creating a huge tax burden.

Conclusions and path forward:

1. "Buy, Borrow and Die" tax planning strategy exists from the creation of the modern tax systems legal way to avoid paying taxes. This strategy revolves around unrealized capital gains from the assets such as shares, bonds, and another alternative, that tend to rise in value each year, whether that increase was paid out in cash or not.
2. The investor buys previously mentioned assets, to accumulate capital gains. By using previously bought assets, as collateral, the high net individual using debt obtain more equity in the form of these assets.
3. Investors use the leverage gain by using debt financing and tax deduction of debt, to pay back the interest and loan, using only proceeds from the assets bought, with minimal need for using equity and in that way increasing the wealth.
4. Investors hold their assets that grow in value until they die. When appreciated assets are passed on to heirs, their tax basis is set at the value at death, and the assets become their value at the time of death, instead of their value at the time when the assets were purchased. The unrealized gains are washed away if the heirs decide to sell itand the accumulated wealth is transferred to the next generation.
5. The modern tax systems reward accumulated wealth and benefit intergenerational transmission of fortune. It creates dynasties the main goal of the trap and maintains wealth true several generations and in that way strengthens wealth inequalities and unequal distribution of wealth.
6. The legislators around the world must limit generational wealth, with the help of taxation by incentivizing taxpayers to transfer assets to more productive owners, not to accumulate it, without creating a huge tax burden, and in that way distribute wealth around the society.

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