Peter Thiel's Five Billion Dollar IRA

A Cambyses Public Policy Analysis

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Cambyses' Public Policy Notes

Cambyses' Public Policy Notes present our analysis of social, legislative, and regulatory developments that affect our constituents. We focus on the topic's

- probable economic, operational, and social impacts, and
- policy and implementation dynamics

We attempt to present objective analyses untainted by our personal perspective and values (which, for the record, are generally liberal and progressive). However, we probably won't always succeed. Review our notes and methodology by referring to the numbered items referenced by, for example [*Number] in and following the main text. We appreciate your feedback - and plan to provide a forum for reasonable disagreement as part of our future development.

Our inaugural Public Policy Discussion examines the actions and responses around Pro-Publica's (and the House Ways and Means Committee's) revelations concerning Mega-IRAs -- very large IRA accounts spawned by investments in ventures that later proved extraordinarily profitable. Since it is the largest, best documented example (and seems to register at about 10-of-10 on the outrage meter) we use Peter Thiel's $5 Billion Roth IRA in our example. (We think you will be surprised by our conclusions!)

The Case For-And-Against Mega-IRAs

According to Pro-Publica, Peter Thiel's Roth IRA balance exceeds $5 Billion (with a B). [*1]

To put that into perspective:

- The reported average IRA balance (2018) is roughly $40 Thousand.
- A lucky or prescient twenty-five-year-old who makes the maximum allowable contribution to an IRA every year from now until they reach age seventy-two would amass roughly $10.2 Million (with an M). Using the current Attained Life table for Minimum Required Distributions as a guidepost to longevity, our twenty-five-year-old could reasonably distribute about $810 Thousand each year. [*2]
- If Peter Thiel (currently 53) retains his IRA until age 72 and follows our 25-year old's investment strategy, with similar results, he would accumulate about $43.1 Billion and distribute $3.4 Billion annually. [*3]

A number of people (including a handful of congresspersons) see Thiel's accumulation as a subversion of the IRA accounts' purpose - which the late Sen. William Roth Jr. identified as allowing "hard-working, middle-class Americans" to save money tax-free for retirement.[*4]

That sentiment is reflected in several proposals, none of them yet enacted, to restrict accumulations or to prohibit several investment strategies in IRA accounts.

- Democratic Senator Ron Wyden, chair of the Senate Finance Committee, was earliest off the mark - proposing, in 2016 and several times since, restrictions if IRA accumulation exceeds $5 Million.
- Massachusetts Democratic Representative Richard Neal, who chairs the House Ways and Means Committee, supports similar restrictions.
- Sen. Ben Cardin supports "reforms, such as banning the use of IRAs to purchase nonpublic investments."
- Both Wyden and Neal indicate that their committees will consider restrictions on Back-Door ROTH Conversions for high balance accounts. (A subject too complex for the present context, but a concern we share with them.)

It helps to look at how Thiel (and several other mega-IRA holders) generated mega-IRAs.

1. In the late 1990's, Thiel invested $2,000 (cash and cash equivalents) in a ROTH IRA.
2. In 1998 or 1999, three years before PayPal (PYPL - previously known as "Confinity") went public, Thiel invested the IRA's funds in a private offering for 1.7 million shares. Pro-Politico concedes PYPL had negligible value at that time (Pro-Politico valued the company at $1,700 at that time!)
3. PayPal went public in 2002 - through a merger with eBay at an offer price capitalization near $1.5 Billion.
4. Subsequent to the lock-up period, Thiel sold portions of his IRA's interest in PayPal-eBay and diversified his remaining IRA portfolio.

Several things are noteworthy about Thiel's chronology:

1. Thiel's household Adjusted Gross Income had to have been under $160,000 ($110,000 if filed Single, HoH, or MFS) if he qualified to make a ROTH IRA contribution in the late 90s [c.f., IRS Publication 590 for 1998, Pages 36-37]. That is hardly an income range that we normally associate with the ultra-wealthy.
2. Thiel's IRA was properly funded using cash and cash equivalents in compliance with funding rules that are still applicable.
3. Contrary to Carden, Neal, and Wyden's assertions, investing in a pre-public venture is not a slam-dunk path to riches. At the time Thiel invested in PayPal, the company had virtually no customers or revenue. According to most sources, somewhere between 90% and 95% of similar start-up firms fail within three years. [*5] Thiel could be criticized for maintaining a high-risk undiversified portfolio in an exempt account (considered a no-no by most Advisors) - but isn't capitalism supposed to reward risk takers?
4. Reports about how much Thiel's 3.7% interest in PayPal-eBay was worth are inconsistent. Market capital for the PayPal-eBay merger transaction is usually cited at around $1.5 Billion - making Thiel's interest worth about $55 Million. (We do not know the composition, initial capital, or subsequent additions Thiel's ROTH portfolio. We are not able to assess the subsequent portfolio performance.)
5. Carden, Neal, and Wyden apparently view Thiel's Post merger disposition and reinvestment as exploitive or opportunistic. We view it as routine portfolio

diversification that achieves long term stability and avoids a seriously skewed risk profile. Most portfolio professionals consider this approach akin to Holy Writ. [*6]

Stripped of its inflammatory context, obligatory outrage and our ever-present urge to "soak the rich" it appears that Thiel

a) played strictly within the rules, and followed sound retirement practices
b) got lucky (or was extraordinarily prescient) with a seriously risky and undiversified portfolio,
c) benefitted from an acquisition trend that made tremendous sense in its context, and
d) diversified in accord with common (and mathematically sanctioned) industry practice.

So, our two questions remain...

Do the proposed IRA restrictions make economic sense?

Cambyses' Thoughts: Value caps on IRA accumulations would be both arbitrary and counterproductive. A) Unless set very high, value caps would penalize, predominantly, those who were diligent, disciplined, and prescient or lucky. B) Set too high, Value caps wouldn't permit us to gratify our apparent need for revenge on those who are more successful than we are. (Not something we at Cambyses think is a very attractive trait to begin with.)

Restricting IRA investment to publicly traded securities impairs capital mobility and market efficiency without fundamentally altering investors' opportunity to manipulate IRA's advantages. (Recall here – the bulk of Thiel's windfall occurred when PayPal merged with eBay in a public market transaction.)

Are IRA accumulation restrictions good-tax-policy?

Cambyses' Thoughts: Do we really want to legislate additional restrictions in order to exact outrage motivated revenge on 500 people who may or may not have provided a proper excuse for outrage?

Sources and Methodology

If you would like to be notified as we publish additional data - let us know by phone or email:

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[*1] Peter Thiel co-founded PayPal with Max Levchin and Luke Nosek in 1998. Elon Musk acquired a significant interest in 2000. Thiel has been an ardent (some would say strident)

advocate for "tax reform" that benefits the 0.1%. Fortune Magazine estimates Thiel's net worth at $4.6 billion in August 2021 - a figure we at Cambyses consider dubious low in light of Thiel's known holdings.

Thiel's ROTH IRA is one of 497 "Mega IRAs" with balances in excess of $25 Million that the House Ways and Means Committee identified. According to that committee 25,000 taxpayers had aggregate IRA account balances of $5 million or more. (c.f., Ways and Means, Neal Wyden Media Release)

Pro-Publica "obtained" what they describe as "a trove of IRS tax return data on thousands of the country's wealthiest people, covering more than 15 years." They have, thus far, declined to reveal their source (likely a "leak" from Treasury records) or share the information. They have, however, published several analyses of the data including:

- The "Trove,"
- Taxing the Rich, and
- Peter Thiel's IRA.

Pro-Publica's analysis and conclusions are tainted by their apparent pre-supposition that almost anything financial that the 0.1% does is unscrupulous and should be outlawed or restricted. This renders Pro-Publica's, otherwise useful, presentation suspect. Read their materials with a critical eye even if (like Steven) you are inclined to agree with some of their conclusions.

Note: In particular, Pro-Publica's analysis of 0.1%ers' tax rates relies on wealth taxation principles that are not embodied in current tax law. Whether those principles should, or should not, be enacted is debatable. Pro-Publica comes down strongly in favor of them – and analyzes their data accordingly.

[*2] Assumptions and Computation: Future Value of annual $6,000 contributions made at the beginning of each year, no withdrawals for forty-seven years (to age 72), stable annual yield of 12%. [Excel Formula: Accumulation = FV(0.12, 47, -6,000)], results rounded to nominal (unadjusted for inflation) dollars.

This performance would be extraordinary if sustained over a forty-seven-year period. Equity portfolio yields for the most recent ten years (which have garnered returns much greater than historical averages) are approximately 9.2% for the overall equity market and 13.2% for the S&P 500 Index. Inflation adjusted, Fifty-Year return for pure equity investment is approximately 6.2%. A portfolio that achieves 12% performance would usually be high risk and would almost certainly exceed most IRA investor's risk tolerance. Planning based on a 12% long term stable yield scenario would be considered foolhardy, or at least naive, by most financial planners.

The payout formula assumes a) market performance equal to average 50-year inflation adjusted yield, b) no significant change in currently estimated attained life expectancy. [Excel Formula: Distribution = PMT(0.062, 25.4, -10,235,303). Note, however, that ROTH IRA's (like Peter Thiel's) are not <u>required</u> to make distributions - minimum or otherwise.

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Under reasonable yield assumptions (6.2%) our hypothetical twenty five year old would amass roughly $1.7 Million and could distribute $134 Thousand annually. [Excel Formulas: Accumulation = FV(0.062,47,6000) and Distribution = PMT(0.062,25.4,-1,687,690)].

[*3] Excel Formulas: Accumulation = 5,000,000,000*(1.12)^19 (Assumes no further contributions to the fund), Distribution = PMT(0.062, 25.4, 43,063,808,450)

Under reasonable yield assumptions (6.2%) Thiel's hypothetical IRA would amass roughly $15.7 Billion and could distribute $1.2 Billion annually. Still well in excess of our lucky 25-year old's accumulation and payout. Excel Formulas: Accumulation = 5,000,000,000*(1.062)^19 (Assumes no further contributions to the fund), Distribution = PMT(0.062, 25.4, 15,679,630,440)

[*4] Internal Revenue Code provisions implement this philosophy by reducing or disallowing deductions for traditional IRA contributions and eliminating the ROTH IRA option for taxpayers who receive over $124,000 of Adjusted Gross Income. (2020 limits, single filing - estimated 2021 limits will be somewhat higher). See USC 26, Sections 408 and 408A, and underlying regulations.

[*5] As some of you are aware, Steven was a principal in a venture-equity fund for close to a decade. Four of thirty-one ventures we funded achieved significant profitability and/or valuation. Eighteen of thirty-one were marginally successful (achieved average profitability and valuations). The rest were marginal or dead cold losses. The companies we funded were a handpicked selection of the best opportunities we discerned from approximately 5,200 funding applications we reviewed during that period. Hence our outcomes have a built-in positive skew. - We have no follow up information regarding the proposals we declined to fund.

[*6] In its simplest qualitative form, Modern Portfolio Theory (MPT) enshrines asset allocation and portfolio diversification as the safest and most effective avenue to sustainable wealth.

It is interesting to note, however, that (with the possible exception of Peter Lynch and Warren Buffet) almost every Fortune 400 estate derives from interests in only one or several investments - often in narrow product-service niches. As F. Scott Fitzgerald observed, the rich "are different from you and me." Paraphrasing Ernest Hemmingway: "Yeah, for one thing, they've got more money."

In sophisticated applications, MPT (sometimes called mean-variance analysis) provides a mathematical framework used to construct portfolios. The algorithm maximizes expected portfolio return for a given level of market risk.

Harry Markowitz proposed the MPT framework in his [1952 Journal of Finance article, "Portfolio Selection."] Markowitz received the 1990 Nobel Prize in Economics for his work.

The majority of investment advisors who advocate "balanced portfolios" subscribe to (or at least give lip service to) MPT in its simple qualitative incarnation.

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Quantitative application software that formalizes MPT is readily available. These applications are extremely data intensive, thus impractical for small advisor companies, and small, or rapid turnover portfolios. They are used extensively by large Mutual and Exchange Traded Funds to predict optimal long term trade strategies.

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