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IN FOCUS

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An Economic Perspective on Wealth Taxes

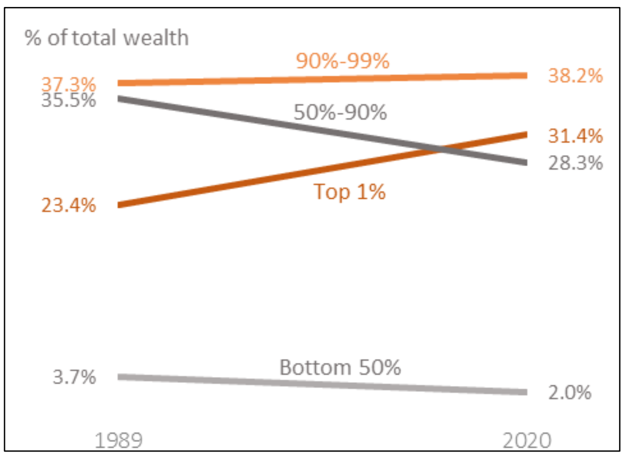
The idea of imposing a tax on individual wealth has appeared in policy debates with increasing frequency. Proponents of a wealth tax have primarily argued that such a tax would achieve three objectives. First, a wealth tax would mitigate rising wealth inequality. Second, the tax would raise significant revenue that could be used to address debt and deficit concerns, and fund a variety of social policies. Finally, the tax would capture some income sources that currently are not taxed (e.g., unrealized capital gains or types of imputed income).

This In Focus presents an economic perspective on wealth taxes. Because no federal wealth tax currently exists, the discussion in this In Focus is primarily in terms of *a general wealth tax*. Designing such a tax would require careful consideration about a number of specific issues. Where appropriate, the discussion highlights specific points of consideration.

Overview

At its most basic level, wealth is the value of all assets (e.g., stocks, bonds, real estate, art) owned by an individual minus the value of their liabilities. As shown in **Figure 1**, the concentration of wealth in the top 10% (i.e., top 1% plus next 9%) of the wealth distribution in the United States has increased over the past 30 years. The increase has been largest for the wealthiest households. The share owned by the top 1% rose by the greatest amount, from 23.4% in the third quarter of 1989 to 31.4% in the fourth quarter of 2020. Over the same time period, the holdings of the top 1% of the wealth distribution have shifted toward stocks and business holdings.

Figure 1. Share of Total Wealth by Wealth Percentile Group in the United States, 1989 to 2020



Source: Board of Governors of the Federal Reserve System.
Notes: Quarterly data from Q3 1989 to Q4 2020.

Selected Policy Considerations

Enactment of a wealth tax would represent a significant change in U.S. tax policy. The change would raise a number of policy issues and questions that Congress may choose to consider.

Revenue Yield

The Joint Committee on Taxation (JCT) would provide Congress with an official revenue estimate of any wealth tax proposal. A number of outside think-tank and academic researchers have proposed revenue estimates of wealth taxes, which vary depending on the assumed design of the tax.

For example, the Tax Policy Center (TPC) examined three stylized wealth taxes:

1. a tax equal to 1% of net wealth over $20 million ($40 million for joint filers);
2. a tax equal to 1% of net wealth between $20 million and $100 million ($40 million and $200 million for joint filers) and 2% of net wealth over $100 million; and
3. a tax equal to 1% of net wealth between $100 million and $1 billion and 2% of net wealth over $1 billion.

The TPC estimates these three versions would raise $1.1 trillion, $1.6 trillion, and $800 billion in revenues, respectively, in the first 10 years, though they emphasize the revenue estimates are highly uncertain.

The uncertainty surrounding wealth tax revenue estimates is illustrated by the broad range of estimates of a legislative proposal by Senator Warren (S. 510). The proposal would levy a 2% tax on net wealth above $50 million *plus* a 1% surtax on wealth over $1 billion. Annual estimates for this proposal range from $117 billion (Smith, Zidar, and Zwick) to $300 billion (Saez and Zucman). The $300 billion figure is an increase from an earlier $275 billion estimate. Saez and Zucman partly attribute the revised estimate to an increase in the concentration of wealth. Authors of these estimates have noted the difficulty in determining the magnitude of behavioral responses and avoidance behavior that would occur if the proposal were enacted.

Valuation

Determining the value of assets is a crucial aspect of implementing a wealth tax. Valuations of bank accounts and assets that are readily traded on financial markets, such as stocks and bonds, would be relatively straightforward, although *when* such valuations were made would be important given fluctuations in asset values over time.

Valuation of land and structures within the United States could also likely be accomplished in a reasonable fashion given the prevalence of state and local property taxes, and templates used by private companies that provide appraisals or estimates of market values for real estate. Valuation of land and property held abroad may be more difficult from an administrative and verification perspective.

Not all assets have a readily available market value. For example, the majority of U.S. businesses are privately held (partnerships, sole proprietorships, S corporations, LLCs). For items such as fine art, wine, antique cars, jewelry, and other collectables, there is often not a liquid market that can be referenced for valuation purposes. Valuing intangible assets (patents, copyrights, etc.) could be one of the more difficult aspects of levying a wealth tax.

Still, there may be practical approaches to consistently, if not accurately, applying values to many assets for tax purposes. Saez and Zucman highlight that Section 409A of the Internal Revenue Code (dealing with deferred compensation plans) provides a potential framework for valuing privately held businesses under a wealth tax, and that the IRS already collects data on private businesses. Likewise, Saez and Zucman point out that collectables are often insured, which requires a valuation be made, and that such assets are a rather small share of total wealth.

Some issues with asset valuation or situations where the tax due exceeds the taxpayer's liquid assets could be addressed using some form of retrospective taxation. This could be especially useful where determining the true value is difficult (patents, copyrights, etc.) or when a taxpayer's wealth is primarily in illiquid or non-income producing assets. Senator Wyden proposed a type of retrospective tax mechanism in the 115th Congress (as part of his mark-to-market capital gains proposal).

Avoidance and Evasion

One of the key drivers of the range of estimated revenue yields presented earlier is the degree of avoidance included in the estimates. Since the United States does not have a wealth tax, these estimates are generally drawn from U.S. estate tax data or from the experiences of other countries—with estimates of avoidance (measured as a reduction in the tax base) ranging from the midteen percentages up to the midforty percentages. However, research by Saez and Zucman highlights the role third-party reporting has had in reducing wealth tax avoidance in other countries, and suggests that with careful design, avoidance rates at or below the lower end of this range could possibly be achieved.

Internal Revenue Service (IRS) estimates of the tax gap (the difference between taxes owed and taxes voluntarily paid) may offer insight into how the design of a wealth tax could limit avoidance or evasion opportunities. In particular, IRS estimates highlight the importance that third-party reporting could have on the rate of noncompliance. In their most recent tax gap study (covering tax years 2011-2013), the IRS found that third-party reporting reduced the noncompliance rate by over two-thirds (from 55% to 17%). A recent working paper by Guyton et al., however, suggests that these estimates may underestimate noncompliance at the top of the income distribution, as they are unlikely to fully account for tax evasion through offshore accounts and pass-through businesses.

In addition to third-party reporting, several general design aspects could limit avoidance or evasion. All else equal, a broader measure of taxable wealth would offer fewer avoidance opportunities. However, the current estate tax offers some insights into planning techniques that could be used to reduce wealth that would otherwise be subject to a wealth tax. These estate tax planning techniques include the use of family trusts, donor-advised funds, and related-party loan agreements. Such tax-planning techniques may warrant attention when designing a wealth tax. Additionally, if a goal of a wealth tax is to target income that escapes taxation under the income tax, there is the potential for the tax on an asset to be greater than the income produced by the asset—creating an effective *income tax rate* greater than 100%—unless wealth tax rates are low.

Constitutionality

In addition to considering the economic issues surrounding a wealth tax, it is equally important to consider whether such a federal tax is permissible under the U.S. Constitution, which requires that a "direct tax"—which some legal scholars contend a wealth tax is—be apportioned among states according to population. There is considerable debate among legal scholars on this issue. For more information on legal aspects of taxation, see CRS Report R46551, *The Federal Taxing Power: A Primer*, by Milan N. Ball.

Alternative Policies

Alternatives policies could potentially achieve a number of the same objectives of a wealth tax. One approach that is perhaps most closely related to a wealth tax is a proposed minimum tax contained in the President's FY2023 budget request. Under the proposal, those with *wealth* exceeding $100 million would be subject to a 20% minimum tax on total *income*, which would include unrealized capital gains. Accompanying the tax would be a requirement that taxpayers report the value of their assets by specified classes.

A second approach could be to adopt the high-income surtax in the Build Back Better Act (BBBA; H.R. 5376). Under the most recent version of the BBBA released by the Senate Finance Committee on December 11, 2021, a flat tax rate of 5% would apply to modified adjusted gross income (MAGI) in excess of $5 million ($10 million married filing jointly) and below $12.5 million ($25 million married filing jointly). MAGI in excess of these thresholds would be taxed at a flat rate of 8%. MAGI generally includes labor, dividend, and realized capital gains income. Thus, in contrast to the proposed 20% minimum tax, unrealized capital gains would not be subject to the surtax.

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