Wealth Taxation: An Overview of the Issues

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Abstract: In January 2019, Senator Elizabeth Warren (D-Massachusetts) proposed that an annual wealth tax be imposed on the 75,000 households with wealth greater than $50 million. Annual wealth taxes have been adopted in a number of European countries (many of which later repealed them), but not in the United States. Although Senator Warren’s proposed tax rates of 2 to 3 percent per year appear low, the tax would actually be equivalent to a high-rate income tax. Due to the pronounced concentration of wealth in the United States, the tax would be highly progressive. The tax would probably reduce national saving and investment to some extent, although capital inflows from abroad would ameliorate the investment reduction. Congress would likely add exemptions for selected assets to the tax, which would be distortionary and diminish the revenue yield. The tax would face compliance and administration challenges as taxpayers undervalued or concealed assets and might be ruled unconstitutional on the ground that it was a direct tax that must be apportioned among the states. On balance, it would be more prudent to pursue any desired increase in tax progressivity through reforms of the income and estate and gift taxes.

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1. Overview of Wealth Taxes

This report examines proposals to impose annual taxes on wealth or net worth. Under a wealth tax, households would pay tax each year based on their net worth, which is the fair market value of their assets minus the fair market value of their liabilities. Wealth taxes generally would apply only to wealth above an exemption amount.

Annual wealth taxes have not been used in the United States. However, the federal government and many states impose estate and gift taxes, which are essentially once-per-lifetime wealth taxes that tax wealth when it is transferred through gift or bequest.

Many European countries have adopted wealth taxes, although a majority of those countries have repealed them. OECD (2018) reported that only four of its member countries – France, Norway, Spain, and Switzerland – were imposing annual wealth taxes in 2017. As Bunn (2019) observed, however, six OECD countries actually had wealth taxes, as the Netherlands imposed a wealth tax embedded within its income tax system and Italy imposed a wealth tax on assets that Italians held abroad. In 2018, France repealed its wealth tax and Belgium introduced one, leaving the number of OECD countries with wealth taxes unchanged at six. The other OECD countries that have repealed wealth taxes are Austria, Denmark, Finland, Germany, Iceland, Ireland, Luxembourg, and Sweden. As discussed below, the repeals were generally motivated by administration and compliance difficulties, undesired behavioral responses such as emigration, and disappointing revenue yields.

Wealth taxation entered the U.S. policy debate in January 2019, when Senator Elizabeth Warren (D-Massachusetts) proposed an annual wealth tax as part of her ongoing campaign for the 2020 Democratic presidential nomination. Her proposal (Warren, 2019) featured a tax rate of 2 percent per year on wealth in excess of a $50 million exemption amount, with a surcharge of 1 percent per year on wealth in excess of $1 billion. Throughout this report, I treat the Warren proposal as a prototype of a potential U.S. annual wealth tax.

A Business Insider poll taken shortly after the Warren proposal was released found that it was supported by 54 percent of the public and opposed by 19 percent. The proposal was supported by 76 percent of self-proclaimed liberals, 36 percent of self-proclaimed conservatives, and 56 percent of those who did not identify with either category (Bryan, 2019). In April, a Quinnipiac University Poll (2019) found support from 60 percent of the public, including 82 percent of Democrats, 63 percent of independents, and 32 percent of Republicans. Sarin and Summers

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1 This report does not examine proposals to impose one-time wealth taxes, sometimes referred to as capital levies.
2 State and local governments also impose property taxes, but, as discussed below, they are quite different from wealth taxes.
3 Although the “yellow-vest” protestors have demanded that France reinstate its wealth tax, President Emmanuel Macron has refused to do so (McAuley, 2019).
4 In 2017, Senator Bernie Sanders (I-Vermont), who is also seeking the Democratic presidential nomination, listed a 1 percent per year wealth tax with a $21 million exemption amount as an option to pay for Medicare for All.
(2019b) noted, however, that the estate and gift taxes lost political support when they came under sustained political attack and suggested that support for wealth taxes might also erode as they receive more scrutiny.

Wealth taxation has drawn support even among affluent households. A June 2019 CNBC survey of persons with net worth above $1 million found that 60 percent supported the Warren proposal, including 88 percent of Democrats, 62 percent of independents, and 36 percent of Republicans (Frank, 2019). Of course, many of those persons would not be subject to the tax because their wealth is below the Warren proposal’s $50 million exemption amount. On June 24, 2019, however, nineteen billionaires who would pay substantial taxes under the Warren proposal released a letter supporting the proposal (Bowditch et al., 2019).

The Warren proposal would tax the worldwide wealth of U.S. citizens (even if living abroad) and of non-citizens who have U.S. permanent resident status or spend significant time in the United States. The proposal would allow tax payments to be deferred for five years, with interest, to address the (perhaps unlikely) possibility that some taxpayers might lack sufficient liquidity to immediately pay the tax. The proposal also included enforcement and anti-avoidance provisions, as discussed below.

2. Effects of Wealth Taxation

2.1 Interpreting Wealth Tax Rates

Although wealth tax rates of 2 or 3 percent may appear to be low, that appearance is deceiving. It is important to realize that the correctly stated rates are 2 percent or 3 percent per year. Because a flow of taxes is imposed on a stock of wealth, the tax rate cannot be stated without specifying a time unit. For a household with constant wealth, under the lower rate in Warren (2019), tax equal to 2 percent of wealth would be paid over the first year, but a cumulative tax equal to 20 percent of wealth would be paid over the first decade. In contrast, no time unit is needed to state income tax rates because a flow of taxes is imposed on a flow of income. Under a 20 percent income tax, tax equal to 20 percent of the first year’s income would be paid during the first year and tax equal to 20 percent of the first decade’s income would be paid during the first decade.

The best way to interpret wealth tax rates is to translate them into equivalent income tax rates. For a taxpayer who holds a long-term bond with a fixed interest rate of 3 percent each year, a 2 percent per year wealth tax is equivalent to a 67 percent income tax and a 3 percent per year wealth tax is equivalent to a 100 percent income tax.

The tax-rate translation is more complicated for risky investments. If a taxpayer holds a stock whose risky return has an expected value of 8 percent per year, a 2 percent per year wealth tax is equal to 25 percent of the expected return. As Sarin and Summers (2019b) observed, however, the true equivalent income tax rate is higher than 25 percent. Part of the stock’s high expected return compensates for the stock’s risk. A 25 percent income tax absorbs 25 percent of the
expected return, but also shares 25 percent of the risk because income tax payments rise and fall as returns rise and fall. Under the wealth tax, however, the taxpayer pays 2 percent per year, regardless of whether the stock price soars or plummet. Because the wealth tax absorbs 25 percent of the expected return without sharing any of the risk, it is more burdensome than a 25 percent income tax. Bulow and Summers (1984) showed that, under certain assumptions, equivalent income tax rates should be computed by treating all assets as earning the same returns as safe assets, which would make tax rates similar to those in the preceding paragraph the right ones to use.

Under the wealth tax, therefore, equivalent income tax rates could approach, or perhaps exceed, 100 percent. Moreover, the wealth tax would be imposed in addition to the income tax, easily pushing the combined equivalent income tax rate above 100 percent. Whether or not such high rates are viewed as desirable, it is important to understand them.

The proposed tax rates of 2 to 3 percent per year are high relative to most of the European tax rates. Bunn (2019) reported wealth tax rates of 0.15 percent per year in Belgium, 0.2 to 0.76 percent per year in Italy, 0.61 to 1.61 percent per year in the Netherlands, 0.85 percent per year in Norway, and 0.2 to 2.5 percent per year in Spain.

The fact that wealth tax payments, unlike income tax payments, would be the same for investors with high returns and those with low returns has several implications. The failure to impose more tax on investors who earn high returns would make the tax less effective at its goal, discussed below, of curbing wealth accumulation. Kaeding and Pomerleau (2019) criticized the wealth tax for not imposing higher tax on investors who, due to monopoly power or special skills, can command windfall returns beyond the returns needed to maintain investment incentives, arguing that such windfall returns can often be taxed with little economic harm. However, Saez and Zucman (2019b) pointed out that some of the apparent windfall returns may be a payoff to past entrepreneurial activity and that the wealth tax’s failure to impose higher tax on such returns helps maintain incentives for such activity.

2.2 Progressivity and Wealth Concentration

An annual wealth tax would be highly progressive because the U.S. wealth distribution is extremely concentrated. Saez and Zucman (2016) estimated that the wealthiest 1 percent of households owned 42 percent of national wealth in 2012, with the top 0.1 percent owning 22 percent and the top 0.01 percent (the top one ten-thousandth) owning 11 percent. They found that wealth shares at the top have sharply increased over the last three or four decades.

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5 The Warren proposal does not provide an income tax deduction for wealth tax payments.
Saez and Zucman (2019a) estimated that Senator Warren’s proposed tax, which has a $50 million exemption amount, would apply to 75,000 households, approximately 0.06 percent of all households. They estimated that those households own 10 percent of national wealth.

As discussed below, part of the wealth tax burden could ultimately be borne by workers in the form of lower wages. Although tax shifting to workers would diminish the tax’s progressivity to some extent, the portion of the burden shifted to workers would probably be modest and the tax would remain highly progressive.

Progressivity may be desired because it allows taxes to be collected from those who can best afford to pay them. Economists generally assume that the loss of utility, or wellbeing, from a dollar tax payment is smaller for persons with more economic resources. Holding everything else equal, raising revenue from a small group of top wealth holders would therefore involve less loss of wellbeing than raising the same revenue from a broader group. Similarly, if the revenue raised from a small group of wealth holders was used to finance government benefits to a broader group, the benefit recipients’ gain in wellbeing would exceed the wealth holders’ loss of wellbeing. Collecting additional revenue from top wealth holders might also be considered a move toward tax fairness.

Most economists believe that a wealth tax could reduce wealth inequality. In April 2019, the University of Chicago Booth School’s Initiative on Global Markets (IGM) Forum asked its ideologically diverse panel of 41 expert economists about their reactions to the statement, “If successfully enforced, Senator Warren’s proposed wealth tax would substantially decrease the share of wealth going to the top 0.1% of wealth-holders after 20 years.” Of the 35 economists who expressed an opinion, 4 strongly agreed, 19 agreed, 9 were uncertain, 2 disagreed, and 1 strongly disagreed (IGM Forum, 2019).

Many supporters of wealth taxation advance a different rationale for taxing top wealth holders. They argue that wealth concentration is harmful because it places too much political power in the hands of a small group and view wealth taxation as a beneficial way to break up that concentration and reallocate political power. However, this rationale is a relatively weak basis for wealth taxation.

To begin, the rationale is subject to challenging normative questions. It is far from clear that the government should define the proper distribution of political power in a free society. One might ask whether the government should seek to weaken other groups, such as the media, universities, and think tanks, which are also likely to have power disproportionate to their numbers. In any event, a wealth tax is unlikely to have a significant impact on the distribution of political power. As Sarin and Summers (2019b) noted, an individual or interest group can become a major political player with tens of millions of dollars, suggesting that billionaires would retain ample scope to wield political influence even if they were heavily taxed. They also pointed out that the
wealth tax would not apply to the nonprofit organizations that wealthy individuals (and others) finance to influence policy.

2.3 Treatment of Wealth Under the Income Tax

Another way to collect more taxes from top wealth holders would be to increase the income taxes that they pay on the income generated by their wealth. However, increased income taxation under current income tax rules would fail to reach unrealized capital gains, which are a major type of income generated by wealth.

When an asset rises in value, the owner experiences economic income from the accrued capital gain, even if the gain has not been realized by selling the asset. In some cases, the owner may be able to turn the accrued gain into cash by borrowing against the appreciated asset or by using other financial strategies. Nevertheless, income tax is generally not imposed on the capital gain until it is realized. Interest-free deferral of a tax reduces its burden because a dollar paid tomorrow is worth less than a dollar paid today. Moreover, if the owner dies without selling the asset, nobody ever pays income tax on the unrealized gain that accrued during the owner’s lifetime. Under the income tax system’s basis step-up provision, the owner’s heirs are treated as if they purchased the asset at its market value on the date of the owner’s death, so they are taxed (if they ever sell the asset) only on gains above that value. When capital gains are realized, they are often taxed at a preferential rate, which also applies to dividends.

Because many top wealth holders experience significant unrealized gains, they are taxed on only part of their economic income. Bourne et al. (2018) found that the annual income reported by top wealth holders on their income tax returns was less than 4 percent of their wealth. Because part of the income received the preferential rate for capital gains and dividends, their tax burden was equivalent to paying ordinary income tax rates on annual income of less than 3 percent of their wealth. The authors noted that the wealth holders’ total returns, including unrealized gains, were likely 8 percent per year or higher.6

Under current income tax rules, there is limited scope for additional taxation of the capital gains of top wealth holders. Eliminating the preferential rate on realized capital gains would still leave unrealized gains outside the tax base and might be counter-productive if it caused taxpayers to realize fewer gains (the “lock-in effect”). The wealth tax would overcome these limitation by directly taxing the asset values.

However, the income tax rules could be changed. The basis step-up rule could be replaced by a basis carry-over rule, so that when heirs (or their heirs, and so on) sell an asset, they would pay income tax on all of the gains that have accrued since the asset was originally purchased, virtually guaranteeing that all of the gains would eventually be taxed. A stronger option would be

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6 For corporate stock, the corporate income tax offsets the lenient individual tax treatment to some extent. That offset does not apply to other assets held by the wealthy.
to tax the accrued gains when the original holder died, so that the tax could never be deferred longer than one generation.

As Thornton and Hendricks (2019) noted, an even more dramatic option would be to tax gains each year as they accrued. Because accrual taxation (sometimes called mark-to-market taxation) would require observing asset values, it would encounter the same valuation challenges, discussed below, that wealth taxes confront. Toder and Viard (2016) proposed mark-to-market taxation, though only for publicly traded assets, whose values can be easily determined. However, Grubert and Altshuler (2016) outlined an interest-charge approach that would have broadly similar effects to mark-to-market taxation without any need to observe market values. Under the interest-charge approach, the gain would not be taxed until the asset was sold (or the asset holder died). At that time, however, an interest charge would be added to the tax liability based on how long the asset had been held, to approximately offset the failure to tax the gain each year as it accrued. Although wealth holders would still be able to defer tax by delaying the asset’s sale, they would have to pay interest on the deferral, effectively removing its economic benefit. Grubert and Altshuler recommended applying the interest-charge approach to all assets. Another possibility would be to apply the interest-charge method to non-publicly-traded assets while applying mark-to-market taxation to publicly traded assets. The methods could be applied to all investors or only to wealthy investors. Mark-to-market taxation and the interest-charge method would be fundamental departures from the principles of the current tax system and would be highly controversial. In those respects, they would be similar to the wealth tax.

Economists do not have a consensus view about whether changes to the existing tax system could substitute for wealth taxation. The IGM Forum’s April 2019 survey asked its panel of 41 expert economists about their reactions to the statement, “A public policy goal that could be accomplished with a well-enforced wealth tax could be equally accomplished with modifications to existing federal taxes – for example, revising the estate tax and/or capital gains tax.” Of the 36 economists who expressed an opinion, 4 strongly agreed, 14 agreed, 7 were uncertain, 11 disagreed, and none strongly disagreed (IGM Forum, 2019).

2.4 Spending, Saving, and Investment

Taxpayers have a choice between spending now and saving to obtain resources to spend in the future. The wealth tax would have two effects on taxpayers’ behavior. First, the tax would reduce the resources available to the taxpayers, which would cause them to spend less, both now and in the future. Second, the tax would reduce the payoff to saving for the future by lowering the after-tax rate of return on saving. By reducing the payoff to saving, the tax would give taxpayers an incentive to spend more now and to spend less in the future.

Although both effects imply that the taxpayers would spend less in the future, they have conflicting implications for whether they would spend more or less now. In their revenue
estimate, discussed below, Saez and Zucman (2019a) assumed that the tax would leave unchanged the amount the taxpayers spend now, which is a reasonable assumption for analysis.

If the taxpayers’ spending remained unchanged, their saving, which equals disposable income minus spending, would fall dollar-for-dollar as the tax payments reduced their disposable income.7 Supporters of the wealth tax would view the taxpayers’ decline in saving as a feature rather than a bug because it would imply that the taxpayers’ wealth buildup was being curbed. The decline in the taxpayers’ saving explains why they would spend less in the future.

As Saez and Zucman (2019b) noted, the wealth tax’s net impact on total national saving would depend on whether any of the tax revenue was saved. If the revenue was used to provide benefit payments, the recipients might save part, though probably not very much, of their benefits. Using the revenue for deficit reduction would boost saving, but it is unclear that the revenue would be used for that purpose. On a more promising note, some of the revenue could be saved in the form of infrastructure investment.

On balance, it is likely that national saving would fall to some extent. Under the unchanged-spending assumption, the taxpayers’ saving would fall by the full amount of the tax payments. Although some of the wealth tax revenue would likely be saved, it is unrealistic to expect that all of it would be saved, meaning that the decline in the taxpayers’ saving would not be fully offset.

A reduction in national saving would be financed by a reduction in investment in factories, equipment, and other capital in the United States, a larger inflow of capital from abroad, or a combination of both. A larger capital inflow, which represents increased borrowing from foreigners, would be manifested in a larger trade deficit. With fewer funds available from American savers to finance investment, investment must fall unless foreign savers supply more funds.

A reduction in investment in the United States would result in a smaller capital stock, making workers less productive and driving down their wages over time. Workers would then ultimately bear part of the burden of the wealth tax. Nevertheless, the decline in investment (and the wage reduction) would be ameliorated because a significant part of the saving decline would probably be financed by increased capital inflows, as Saez and Zucman (2019b) noted. The Congressional Budget Office uses a central estimate under which 57 percent of a decline in national saving is financed by a reduction in investment (with the other 43 percent financed by larger capital inflows), but also considers alternative assumptions under which the investment reduction is 71 percent or 39 percent, rather than 57 percent, of the saving reduction (Huntley, 2014).

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7 If the taxpayers increased their spending in response to the tax, their saving would fall by more than the amount of their tax payments; if they reduced their spending, their saving would fall by less than the amount of their tax payments.
2.5 Breadth of Tax Base

Wealth taxes can have broad tax bases that cover almost all types of assets or narrow tax bases that exempt many types of assets. A broad tax base would be preferable because it would treat different assets neutrally and would raise any given amount of revenue at a lower tax rate. Warren (2019) called for a very broad tax base consisting of “all household assets … including residences, closely held businesses, assets held in trust, retirement assets, assets held by minor children, and personal property with a value of $50,000 or more.”

Unfortunately, the international experience suggests that it would be difficult to adopt a wealth tax with a broad base. Brumby and Keen (2018) stated, “The design of wealth taxes is notoriously prone to lobbying and the granting of exemptions that the wealthiest can exploit,” and OECD (2018) described how lobbying led to exemptions being granted under European wealth taxes. Edwards (2019) noted that many of the European taxes provided exemptions for farm assets, small businesses, pension assets, artwork, and other items. Taxpayers holding exempt assets were still allowed to deduct their full liabilities, yielding an even more distorted picture of their net worth. Leiserson, McGrew, and Kopparam (2019) provided a detailed tabulation of asset exemptions in past and present European wealth taxes.

Davison (2019) predicted that groups representing home buyers, investors, and collectors would similarly press for exemptions under a U.S. wealth tax. Saez and Zucman (2019b) countered that the Warren proposal would apply only to a small group of households with wealth above $50 million, whose pleas for asset exemptions would draw little political support. However, that argument seems difficult to reconcile with wealth tax supporters’ contention that top wealth holders have considerable political power.

Exemptions would directly reduce the tax’s revenue yield. They would also encourage taxpayers to inefficiently shift from taxed assets to exempt assets, which would further reduce the revenue yield. Such shifting was observed in France, Germany, Norway, and Spain (Davison, 2019).

2.6 Administration, Avoidance, and Evasion

Under an annual wealth tax, the fair market values of all assets and liabilities would need to be determined each year for all households with wealth (potentially) above the exemption amount. Bank accounts and publicly traded financial assets would be straightforward to value, but non-publicly-traded assets, such as land, houses, privately held businesses, artwork, and furniture, would pose difficulties. Taxpayers would have the opportunity to conservatively value, or flatly undervalue, those assets to some extent. Taxpayers might also illegally conceal assets. Moreover, taxpayers might shift their holdings toward assets that are easier to undervalue or conceal; for example, some households might move their wealth abroad because foreign assets might be easier to conceal.
Two other types of taxes, property taxes and estate and gift taxes, must also detect and value assets. However, those tax systems generally perform these tasks on a smaller scale than the wealth tax would and they often do not perform them well. Their experience therefore offers limited encouragement about the wealth tax’s ability to detect and value assets. State and local property taxes are imposed each year and apply to a vastly larger group of taxpayers than the small group that would be subjected to the wealth tax. However, property taxes primarily apply to land and structures located in the United States, thereby avoiding some of the appraisal challenges and virtually all of the concealment challenges faced by the wealth tax. Pomerleau (2019) examined the differences between property taxes and wealth taxes. Moreover, property tax appraisals are notoriously inaccurate. The estate and gift tax system must value all types of assets and it applies to a somewhat larger group of people than those subject to Warren’s proposed tax. However, the tax is imposed only when assets are conveyed by gift or bequest rather than every year; the IRS processes 4,000 estate tax returns each year but would process 75,000 wealth tax returns each year under the Warren proposal (Davison, 2019). Estate and gift tax valuations are also imperfect, although probably not to the same extent as property tax appraisals.

International experience has been mixed. Edwards (2019) and Davison (2019) noted that administration and compliance issues played a role in several European countries’ decisions to repeal their wealth taxes, with Rosalsky (2019) citing it as the key factor in Austria’s 1993 repeal. Saez and Zucman (2019b) reported that wealth tax avoidance and evasion were modest in Sweden and Denmark, which had extensive third-party reporting of wealth, but were more severe in Columbia and Switzerland, where enforcement was weaker.

Warren (2019) called for a significant increase in the IRS enforcement budget, a minimum audit rate for the households subject to the wealth tax, and systematic third-party reporting based on existing international agreements to exchange tax information. However, those international agreements, which Schneidman (2019) described in detail, apply only to financial assets, not tangible assets. Wamhoff (2019) argued that a dramatic increase in IRS enforcement resources could be financed by a tiny fraction of the wealth tax revenue.

Saez and Zucman (2019b) and Wamhoff (2019) offered proposals to improve administration and compliance. For example, Saez and Zucman proposed increased information reporting on financial assets, valuing businesses based on book values of assets or by applying multipliers to annual profits, and valuing artwork by its insurance value. Wamhoff suggested that state and local governments be empowered to acquire property through eminent domain at a price equal to the value that owners reported for wealth tax purposes. Stein (2019) surveyed the uncertain outlook for wealth tax enforcement.

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8 For decedents dying in 2019, the estate tax applies if the decedent’s estate plus cumulative lifetime taxable gifts exceed $11.4 million ($22.8 million for married couples).
Most economists believe that the wealth tax would face significant administration and compliance challenges. The IGM Forum’s April 2019 survey asked its panel of 41 expert economists about their reactions to the statement, “Senator Warren’s proposed wealth tax would be much more difficult to enforce than existing federal taxes because of difficulties of valuation and the ways by which the wealthy can under-report their true wealth.” Of the 37 economists who expressed an opinion, 9 strongly agreed, 21 agreed, 4 were uncertain, 3 disagreed, and none strongly disagreed (IGM Forum, 2019).

Individuals could legally avoid the wealth tax by emigrating and renouncing their United States citizenship (for simplicity, “expatriating”). Edwards (2019) noted that wealth taxes in France and Sweden prompted some high-wealth individuals to emigrate. Edwards (2019) and Davison (2019) reported that emigration helped prompt France to repeal its tax. However, expatriation by Americans is generally more difficult than moving within the European Union. Warren (2019) also called for an “exit tax” equal to 40 percent of wealth in excess of $50 million on Americans who expatriate. Such a tax would likely deter most potential expatriations and would also offset part of the revenue loss that would arise from any remaining expatriations. As Stein (2019) noted, the exit tax could be applied retroactively to individuals who expatriated while the tax was being considered but before it was enacted.

Taxpayers could also avoid the tax by giving assets to relatives (other than spouses and unmarried minor children) whose wealth was below the exemption amount. Although such gifts would reduce the tax’s revenue yield, Saez and Zucman (2019b) argued that they would advance the tax’s goal of breaking up concentrated wealth. They also acknowledged that the tax could be avoided by giving wealth to foundations and other charities, but argued that such gifts would be socially beneficial.

2.7 Revenue Yield

As mentioned above, Saez and Zucman (2019a) estimated a $2.75 trillion revenue yield over ten years from the Warren proposal, including approximately $200 billion in the first year. Their estimate allowed for a 15 percent revenue loss from tax avoidance and evasion. Wamhoff (2019) used a similar methodology to estimate a ten-year revenue yield of $1.26 trillion for a 1 percent per year wealth tax with an exemption amount set at a level that would make the tax applicable only to the top 0.1 percent ($32.2 million in 2020).

Using a different methodology, Summers and Sarin (2019) obtained a radically lower revenue estimate, highlighting the important role played by the breadth of the tax base and the scope for evasion and avoidance. Based on mortality data, they estimated that the once-in-a-lifetime 40 percent estate tax is equivalent to a 0.8 percent per year annual wealth tax. Because the estate tax raises $10 billion per year from estates larger than $50 million, they estimated that a 2 percent per year annual wealth tax would raise $25 billion per year, approximately one-eighth of the Saez-Zucman estimate. Although they acknowledged that some upward adjustments to their
estimate might be warranted, they concluded that “it is likely extremely premature to bank on anything like the $200 billion plus that Saez and Zucman estimate.” Urban-Brookings Tax Policy Center co-director Eric Toder recently commented that there was reason to think that the Saez-Zucman estimate “might be on the high side” and Owen Zidar of Princeton University stated that avoidance and evasion “might make it hard to collect as much you expect” (Schor, 2019).

By basing their estimate on the current estate tax, Summers and Sarin effectively assumed that Congress would add to the wealth tax the same type of base-narrowing provisions that it has adopted under the estate tax and that taxpayers would be able to use the same types of strategies to avoid the wealth tax that they use to avoid the estate tax. They argued that those assumptions were likely to hold. They also noted that many tax proposals end up raising much less revenue than a simple analysis of macroeconomic data would suggest. However, Gene Sperling, former economic adviser to Presidents Clinton and Obama, countered that the “miserable state of enforcement of the estate tax” could be “improved with smart public policy” and should not be treated “as an immovable part of nature” (Schor, 2019).

Under the Saez-Zucman estimate, wealth tax revenue would be approximately 1 percent of GDP. That revenue yield would be high relative to most, but not all, European taxes. Leiserson, McGrew, and Kopparam (2019) reported that Norway’s tax raises 0.4 percent of GDP and Saez and Zucman (2019b) noted that Spain’s tax and France’s former tax raised 0.2 percent of GDP. However, Switzerland’s tax raised approximately 1 percent of GDP. Davison (2019), Edwards (2019), and Rosalsky (2019) reported that disappointing revenue yields played a role in some European countries’ decisions to repeal their wealth taxes.

Due to the wealth tax’s novelty, its revenue yield is difficult to determine. Farley (2019) provided a thorough and fair assessment of the ongoing debate. On balance, it is reasonable to assume that revenue would fall somewhat short of the Saez-Zucman estimate. Despite Senator Warren’s commendable embrace of a broad tax base, Congress would likely narrow the tax base, in accord with European practices and its own estate tax practices.

Even if the wealth tax raised revenue equal to 1 percent of GDP, the tax would be only part of what would be required to restore long-run fiscal balance. Congressional Budget Office (2018) estimated that, under current spending policies, revenue equal to 1.9 percent of GDP would be required to keep the debt-to-GDP ratio from rising over the next three decades. If spending was increased through the adoption of measures such as Medicare for All or the Green New Deal, considerably more revenue would be required. Of course, the challenging fiscal outlook does not mean that the wealth tax should not be adopted; on the contrary, a larger revenue need strengthens the case for considering all revenue-raising options. It does mean, however, that the wealth tax should not be adopted under the misconception that it would solve the nation’s long-run fiscal problems or fully finance all of the spending increases now under consideration.
3. Constitutional Questions

A federal wealth tax would face potential constitutional challenges. The original Constitution required that all “direct” federal taxes be apportioned among states in proportion to their population, although the Sixteenth Amendment, adopted in 1913, exempted income taxes from that requirement. If the wealth tax was apportioned, rates would be lower in states with higher per-capita wealth in order to equalize per-capita tax liabilities across states. That rate differentiation would be a severe flaw, making an apportioned wealth tax unattractive.

The wealth tax would escape the apportionment requirement if it was either an indirect tax or an income tax. The classification of the tax would depend upon unresolved legal issues and the tax’s features.

It is generally understood that a tax on real property would be a direct tax and would have to be apportioned. The U.S. Supreme Court ruled in 1796 that a tax on personal property (in that case, carriages) was an indirect tax that need not be apportioned.9 The Court ruled in 1881 that income taxes were indirect and did not need to be apportioned even though income from real property was in the tax base.10 However, the Court overruled that decision in 1895 (and backed away from its 1796 decision), holding that taxes on income from either real or personal property were direct taxes and had to be apportioned.11 In later decisions, however, the Court moved toward a narrower definition of direct taxes. It ruled in 1900 that the estate and gift tax was an indirect tax imposed on the privilege of conveying property by gift or bequest rather than a direct tax on property and therefore did not need to be apportioned.12 Similarly, it ruled in 1910 that the corporate income tax was an indirect tax imposed on the privilege of operating in corporate form rather than a direct tax on income from property and therefore did not need to be apportioned.13 Of course, the adoption of the Sixteenth Amendment in 1913 made it irrelevant whether income taxes are direct.

It is difficult to discern from the Court’s decisions whether a wealth tax would be a direct tax. The tax base includes real and personal property, but the tax allows a deduction for liabilities. When she introduced her proposal, Senator Warren released two letters, Ackerman et al. (2019) and Johnsen et al. (2019), from 17 law professors stating that the tax would be indirect and would not need to be apportioned. Johnsen and Delinger (2018) provided a more complete exposition of that position and Wamhoff (2019), Feldman (2019), and Thornton and Hendricks (2019) also argued that a wealth tax would probably be an indirect tax. Other commentators were less sanguine. Freeman (2019) and Khan (2019) argued that the wealth tax would be a direct tax. Bishop-Henchman (2019) noted that the issue was unclear, but said that he was inclined to think

9 Hylton v. United States, 3 U.S. 171 (1796).
12 Knowlton v. Moore, 178 U.S. 41 (1900).
that the wealth tax would be a direct tax. Barro (2019) surveyed the uncertainty, concluding that the wealth tax would face a significant risk in court. Sarin and Summers (2019b) argued that it would be dangerous to put significant political effort into a wealth tax that the courts might strike down as unconstitutional.

Even if a straight wealth tax would be a direct tax that would have to be apportioned, suitable modifications might transform it into either an indirect tax or an income tax. Glogower (2019) proposed that high-wealth households be required to make tax payments that would be labeled as additional income taxes rather than as wealth taxes, despite being based on wealth; it is unclear whether the courts would accept that disguise. It also might be possible to label the wealth tax as an income tax on presumed returns from wealth, as the Netherlands does, or to treat the wealth tax as an advance payment of estate and gift taxes.

A final option would be to reluctantly accept apportionment. Buchanan (2019), arguing that an apportioned wealth tax would be better than none, proposed that the wealth tax legislation include a fallback provision that would institute an apportioned tax if the courts ruled that the unapportioned tax was unconstitutional. He also conjectured that the courts might be more reluctant to strike down the unapportioned wealth tax if they knew that it would automatically be replaced by an apportioned wealth tax, a replacement that nobody would welcome.

4. Conclusion

Annual wealth taxation is one strategy for taxing extremely wealthy households, including those who defer or escape income tax on their unrealized capital gains. However, a wealth tax would pose administrative and constitutional difficulties. Assuming for purposes of discussion that taxes should be increased on the affluent, it may be prudent to pursue that goal through other policies that would not pose the same difficulties. A number of commentators who favor increased taxation of the rich, including Sarin and Summers (2019a), Washington Post (2019), and Hemel (2019), persuasively argued that it would be better to pursue reform of the income tax and estate and gift taxes.

Sarin and Summers outlined a package of progressive income tax changes that they estimate would bring in $2.83 trillion over ten years, slightly more than the Saez-Zucman estimate of the wealth tax’s revenue yield. Revenue estimates for the Sarin-Summers proposals are likely to be more reliable because they are reforms of the existing tax system rather than a completely new tax. The proposals’ actual revenue yield would therefore likely be close to their estimated yield, while, as discussed above, the wealth tax’s actual revenue yield might be significantly lower than the Saez-Zucman estimate.

One of the Sarin-Summers proposals would replace basis step-up with basis carry-over, so that, as explained above, capital gains not realized during a taxpayer’s lifetime would be taxed when an heir eventually sold the appreciated asset. Although the proposed tax changes would primarily
be borne by affluent taxpayers, they would not fall exclusively on the 75,000 wealthiest households. Accordingly, they would not be quite as progressive, and would not do quite as much to break up the concentration of wealth, as Senator Warren’s proposed wealth tax. Some wealth tax supporters might therefore find them a disappointing substitute. As discussed above, however, there is little reason to think that breaking up the concentration of wealth would have much impact on the distribution of political power in the United States. And significant increases in progressivity can clearly be achieved without imposing the entire burden on 75,000 households.

Although the wealth tax is a bold proposal, bold is not always better.
References


