Wealth Taxation: An Overview of the Issues

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ABSTRACT

Two Democratic presidential candidates, Senator Elizabeth Warren (D-Massachusetts) and Senator Bernie Sanders (I-Vermont), have proposed annual wealth taxes on extremely wealthy households. Annual wealth taxes have been adopted in a number of European countries (many of which later repealed them), but not in the United States.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 the proposed wealth tax rates appear low, they are equivalent to high-rate income taxes. Due to the pronounced concentration of wealth in the United States, a wealth 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, which would be distortionary and diminish the tax's revenue yield. The tax would face compliance and administration challenges due to undervaluation and concealment of assets and it might be ruled unconstitutional in the absence of suitable modifications. Although those challenges would probably not be insurmountable, it would be simpler and more prudent to pursue any desired increase in tax progressivity through reforms of the income tax and estate and gift taxes.

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1. Overview of Wealth Taxes

This chapter examines proposals to impose annual taxes on wealth or net worth.[1] 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 are paid when wealth is transferred through gift or bequest.[2]

Many European countries have adopted annual wealth taxes, although a majority of those countries subsequently repealed them. The Organisation for Economic Co-operation and Development (OECD) reported in 2018 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 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.

In January 2019, Senator Elizabeth Warren (D-Massachusetts) proposed an annual wealth tax as part of her campaign for the 2020 Democratic presidential nomination. Her proposal (Warren, 2019a) featured a tax rate of 2% per year on wealth in excess of a $50 million exemption amount, with a rate of 3% per year on wealth in excess of $1 billion. In September 2019, Senator Bernie Sanders (I-Vermont), who is also seeking the Democratic presidential nomination, proposed a wealth tax on households with wealth above $16 million for singles ($32 million for married couples). The tax rates in his proposal (Sanders, 2019) would start at 1% per year and would reach 8% per year on wealth above $5 billion ($10 billion for married couples). In November 2019, Senator Warren revised her proposal, raising the tax rate on wealth in excess of $1 billion to 6% per year (Warren, 2019b). Congressional Democrats have generally been reluctant to embrace the proposed wealth taxes (Elis, 2019).

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1 This chapter does not examine proposals to impose one-time wealth taxes, sometimes referred to as capital levies.

2 State and local governments impose annual property taxes, but they are significantly different from wealth taxes. They primarily apply to real property and they do not allow a deduction for the taxpayer's liabilities. Pomerleau (2019) examined the differences between property taxes and wealth taxes.

Multiple public opinion polls have found majority support for wealth taxation, with the strongest support from political liberals and Democrats. A Business Insider poll taken shortly after the Warren proposal was released found that it was supported by 54% of the public and opposed by 19%. The proposal was supported by 76% of self-proclaimed liberals, 36% of self-proclaimed conservatives, and 56% of those who did not identify with either category (Bryan, 2019). In April, a Quinnipiac University Poll (2019) found support from 60% of the public, including 82% of Democrats, 63% of independents, and 32% of Republicans. Sarin and Summers (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 may 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% supported the Warren proposal, including 88% of Democrats, 62% of independents, and 36% 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. In June 2019, however, 19 multimillionaires and billionaires who would pay substantial taxes under the Warren proposal released a letter supporting the proposal (Bowditch et al., 2019). In September 2019, Microsoft Corp. founder Bill Gates said that he "would not be against" a wealth tax (Metcalf & Schatzker, 2019).

The proposed wealth taxes would apply to the worldwide wealth of U.S. citizens (even if living abroad) and of non-citizens who have U.S. permanent resident status or spend specified amounts of time in the United States. The Warren proposal would allow tax payments to be deferred for 5 years, with interest, to address the (perhaps unlikely) possibility that some taxpayers might lack sufficient liquidity to immediately pay the tax. The proposals also include enforcement and anti-avoidance provisions, as discussed below.

2. Effects of Wealth Taxation

2.1 Interpreting Wealth Tax Rates

Although wealth tax rates of 6% or 8% may appear to be low, that appearance is deceiving. It is important to realize that the rates are actually 6% or 8% *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 a 6% annual wealth tax, tax equal to 6% of wealth would be paid over the first year, but a cumulative tax equal to 60% of wealth would be paid over a 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 30% income tax, tax equal to 30% of each year's income would be paid each year and tax equal to 30% of each decade's income would be paid each decade.

A useful 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% per year, a 6% per year wealth tax is equivalent to a 200% income tax because the tax equals 200% of the taxpayer's interest income. Similarly, an 8% per year wealth tax is equivalent to a 267% income tax.

The tax-rate translation is more complicated for risky investments. Suppose that, alongside her holdings of the 3% bond, the taxpayer holds a stock with an annual return that could fall anywhere between 2% and 10%, with an expected value of 6%. The 6% per year wealth tax could end up being anywhere from 60% to 300% of the stock's return. It is not immediately clear what income tax rate the taxpayer would perceive as equivalent to the wealth tax in advance, when the stock return is uncertain. At first glance, it may seem that the 6% per year wealth tax is equivalent to a 100% income tax rate, which would also result in an expected tax payment of 6% per year. As Sarin and Summers (2019b) observed, however, the wealth tax payment, which is a fixed fraction of wealth, cannot be compared to the expected value of the uncertain income tax payment, because the payments have different risk characteristics.

The puzzle can be solved by observing that the taxpayer should normally hold a mix of the stock and the bond that makes her equally content with both assets on the margin. In that case, the risky stock return and the safe bond return must be equally attractive on the margin, despite the differences in their expected returns. A 200% tax on the bond return (which is equivalent to the 6% per year wealth tax) and a 200% tax on the risky stock return must then be equally burdensome. The wealth tax's equivalent income tax rate is therefore 200% for the stock as well as for the bond. Similarly, an 8% per year wealth tax would be equivalent to a 267% income tax for the stock as well as for the bond. The conclusion that wealth taxes' equivalent income tax rates should be computed by treating all assets as earning the same return as safe assets must be modified if financial frictions or other factors prevent investors from choosing portfolios that make them equally content with all assets on the margin. However, the conclusion is likely to be a reasonable approximation, particularly for wealthy taxpayers, who are likely to face few financial frictions. Bulow and Summers (1984) provide further discussion of the taxation of risky returns.

Wealth taxes can be equivalent to extremely high income tax rates. Moreover, the wealth tax would be imposed in addition to the income tax, making total tax rates even higher. Whether or not such high rates are viewed as desirable, it is important to understand them.

The proposed top tax rates in Warren (2019b) and Sanders (2019) are far higher than European wealth tax rates. Bunn (2019) reported rates of 0.15% per year in Belgium, 0.2% to 0.76% per year in Italy, 0.61% to 1.61% per year in the Netherlands, 0.85% per year in Norway, and 0.2% to 2.5% per year in Spain.

The fact that wealth tax payments, unlike income tax payments, would be the same fraction of wealth for investors with high returns and those with low returns has several implications. The failure to impose additional tax on investors who earn higher returns would make the tax less effective at its goal, discussed below, of curbing wealth concentration. Kaeding and Pomerleau (2019) criticized the wealth tax for not imposing additional 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. Guvenen, Kambourov, Kuruscu, Ocampo-Diaz, and Chen (2019) argued that the wealth tax's failure to impose higher tax on entrepreneurs with special skills is desirable because it reallocates funds toward those entrepreneurs, thereby increasing aggregate productivity.

2.2 Progressivity and Wealth Concentration

An annual wealth tax would be highly progressive. A broad range of estimates find that the U.S. wealth distribution is extremely concentrated and has become more concentrated in recent decades, although there is disagreement about the magnitude. Saez and Zucman (2016) estimated that the wealthiest 1% of households owned 42% of national wealth in 2012, with the top 0.1% owning 22% and the top 0.01% (the top one ten-thousandth) owning 11%. Smith, Zidar, and Zwick (2019, 26) found somewhat less concentration, estimating that the top 1% owned 31% of national wealth in 2014, with the top 0.1% owning 15% and the top 0.01% owning 7%.

Saez and Zucman (2019a) estimated that Senator Warren's proposed tax would apply to 75,000 households, approximately 0.06% of all households. They estimated that those households own 10% of national wealth. Saez and Zucman (2019d) estimated that Senator Sanders' proposed tax would apply to 180,000 households, approximately 0.15% of all households. Even if a small portion of the wealth tax burden were shifted to workers in the form of lower wages (a possibility discussed below), 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 well-being, 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 well-being than raising the same revenue from a broader group. Similarly, if the revenue raised from a small group of wealth holders were transferred to a broader group, the recipients' gain in well-being would exceed the wealth holders' loss of well-being, unless the transfer caused large inefficiencies. Collecting additional revenue from top wealth holders might also be considered a move toward tax fairness.

Many supporters of wealth taxation advance a different rationale, arguing that the reduction of wealth concentration is inherently beneficial. Senator Sanders invoked that rationale on the day that he released his plan, tweeting "There should be no billionaires" (Cillizza, 2019). One justification for objecting to wealth concentration is that it places too much political power in the hands of a small group. However, this argument does not provide a convincing rationale for wealth taxation.

To begin, the rationale can be challenged on normative grounds. 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 probably not apply to the nonprofit organizations that wealthy individuals (and others) finance to influence policy.

Most economists believe that a wealth tax could significantly 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, four strongly agreed, 19 agreed, nine were uncertain, two disagreed, and one strongly disagreed (IGM Forum, 2019).

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.[3] 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 capital gains are realized, they are usually taxed at preferential rates, which typically also apply to dividends.

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, under the income tax system's realization principle, income tax is generally not imposed on the capital gain until it is realized through sale of the asset. That interest-

3 The income tax system also fails to tax the rental value of personal residences and the value of the services provided by other consumer durable goods and collectibles.

free tax deferral reduces the owner's tax 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 that accrued after the owner's death.

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% of their wealth. Because part of their income received the preferential rates for capital gains and dividends, their tax burden was equivalent to paying ordinary income tax rates on annual income of less than 3% of their wealth. The authors noted that the wealth holders' total annual returns, including unrealized gains, were likely 8% or higher.[4]

Under current income tax rules, there is limited scope for additional taxation of the capital gains of top wealth holders. Eliminating the preferential rates 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 limitations 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 gains would eventually be taxed. A more aggressive option would tax the accrued gains when the original holder died, so that the tax could never be deferred beyond the original holder's lifetime.

More dramatic options become available if the realization principle is discarded. Under mark-to-market taxation, gains would be taxed each year as they accrued, even if the assets had not been sold. Gains could easily be taxed at ordinary income tax rates rather than the current preferential rates because the lock-in effect would no longer be an issue. Warren (2019b) proposed mark-to-market taxation of capital gains at ordinary income tax rates for the wealthiest 1% of taxpayers, in addition to a wealth tax. Because mark-to-market taxation would require asset values to be determined, it would encounter the same valuation challenges, discussed below, that wealth taxes confront. Toder and Viard (2016) proposed mark-to-market taxation of capital gains at ordinary income tax rates, though only for publicly traded assets, whose values can be easily determined. However, Grubert and Altshuler (2016) outlined an interest-charge

4 For corporate stock, the corporate income tax offsets the lenient individual tax treatment to some extent. However, that offset does not apply to other assets held by the wealthy.

method that would have broadly similar effects to mark-to-market taxation while largely avoiding the need to determine market values. Under the interest-charge method, 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 asset 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. Market values would not need to be determined, except at death (when valuation might already be required for estate tax purposes). Grubert and Altshuler recommended using the interest-charge method for all assets.

The best approach may be to use the interest-charge method for assets that are not publicly traded while using mark-to-market taxation for publicly traded assets. In September 2019, Senator Ron Wyden (D-Oregon) proposed that approach for wealthy investors (Wyden, 2019). Like wealth taxation, a combination of mark-to-market taxation and the interest-charge method would be a fundamental change to the tax system and would be controversial. However, that approach would not require the creation of a completely new tax and it would largely avoid the need to determine the values of assets that are not publicly traded. Moreover, Viard (2014) argued that effective income tax administration may eventually require a movement away from the realization principle anyway. Batchelder and Kamin (2019) discuss mark-to-market taxation and other methods of taxing the wealthy.

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 also asked its panel of 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, four strongly agreed, 14 agreed, seven were uncertain, 11 disagreed, and none strongly disagreed (IGM Forum, 2019).

2.4 Saving and Investment

Saez and Zucman make the reasonable assumption that the tax would not change the fraction of wealth that taxpayers spend each year. Under that assumption, the taxpayers' saving, as a fraction of wealth, would fall by an amount equal to the wealth tax rate. Supporters of the wealth tax would view the taxpayers' decline in saving, which is a slowdown in their wealth accumulation, as a feature rather than a bug. A 6% per year wealth tax would reduce the taxpayer's wealth (relative to what it otherwise would have been) by 60% over 15 years and by 84% over 30 years. An 8% per year wealth tax would reduce wealth by 71% over 15 years and by 92% over 30 years. Saez and Zucman (2019d) tabulate the sharp reductions in top billionaires' wealth that would have occurred if wealth taxes had been in effect since 1982.

The reduction in the taxpayers' saving would initially equal wealth tax revenue, but the saving reduction would be larger than revenue in subsequent years. In addition to falling by the amount of the tax payment, saving would also fall because the taxpayers would have lower accumulated wealth from which to save.

As Saez and Zucman (2019b) noted, the wealth tax's net impact on total national saving would depend on the extent to which any of the tax revenue was saved. Although some of the revenue could be saved through deficit reduction and infrastructure investment, very little of the revenue might be devoted to those purposes. Sanders (2019) stated that the revenue would be used to pay for affordable housing, universal childcare, and part of Medicare for All, while Warren (2019a; 2019b) stated that the revenue would be used for "badly needed investments in rebuilding our middle class" and to cover part of the costs of Medicare for All. Some uses of the revenue might increase human capital, a form of saving that is not included in the national income accounts.

A reduction in national saving would be financed by a reduction in investment in factories, equipment, and other capital in the United States, by a larger inflow of capital from abroad, or by 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 lowering 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% of a decline in national saving is financed by a reduction in investment (with the other 43% financed by larger capital inflows), but also considers alternative assumptions under which the investment reduction is 71% or 39% of the saving reduction (Huntley, 2014). Only a small portion of the wealth tax burden would likely be shifted to workers.

It should be noted that alternative methods of taxing the wealthy, such as mark-to-market taxation and the interest-charge method, would also be likely to reduce national saving.

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 (2019a) 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 various interest groups 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. That argument seems plausible, although it may be difficult to reconcile with the contention that top wealth holders have excessive political power.

Exemptions would directly reduce the tax's revenue yield. They would also encourage taxpayers to inefficiently shift their holdings 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).

It should be noted that Congress might also add asset-specific exemptions to alternative methods of taxing the wealthy, such as mark-to-market taxation and the interest-charge method. For example, Wyden (2019) would exempt some personal residences and family farms.

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 assets that are not publicly traded, 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. 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.[5] However, the tax is imposed only when assets are conveyed by gift or bequest rather than every year; the Internal Revenue Service (IRS) processes 4,000 estate tax returns each year but would process 75,000 wealth tax returns each year under the Warren proposal and 180,000 returns each year under the Sanders proposal (Davison, 2019). Estate and gift tax valuations are also highly imperfect.

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 (2019a) and Sanders (2019) called for significant increases in the IRS enforcement budget, minimum audit rates for households subject to the wealth tax, and third-party reporting of financial assets based on existing international agreements. Wamhoff (2019) pointed out that a dramatic increase in IRS enforcement resources could be financed by a tiny fraction of the wealth tax revenue.

Saez and Zucman (2019e) 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 outlook for wealth tax enforcement.

5 For decedents dying in 2020, the estate tax applies if the decedent's estate plus cumulative lifetime taxable gifts exceed $11.58 million ($23.16 million for married couples).

Most economists believe that the wealth tax would face significant administration and compliance challenges. The IGM Forum asked its panel of 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, nine strongly agreed, 21 agreed, four were uncertain, three disagreed, and none strongly disagreed (IGM Forum, 2019).

Individuals could legally avoid the wealth tax by emigrating *and* renouncing their U.S. 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 (2019a) also called for an “exit tax” equal to 40% of wealth in excess of $50 million on Americans who expatriate and Sanders (2019) proposed a similar tax, but with a 60% tax rate on wealth in excess of $1 billion. Such an exit tax would likely deter many potential expatriations and would 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 wealth 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 (2019e) 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

Saez and Zucman (2019a) estimated a $2.75 trillion revenue yield over 10 years from the original Warren (2019a) proposal, including $212 billion in the first year. Warren (2019b) stated that the modified proposal would raise an additional $1 trillion over 10 years. Saez and Zucman (2019d) estimated a $4.35 trillion revenue yield over 10 years from the Sanders proposal, including $335 billion in the first year. Their estimates allowed for a 15% revenue loss from tax avoidance and evasion. It seems likely, however, that avoidance and evasion would be larger under the Sanders (2019) and Warren (2019b) proposals, due to their higher tax rates. Smith, Zidar, and Zwick (2019) estimated lower revenue yields for the original Warren proposal based on their lower estimates of wealth concentration. Their estimates also found that a larger portion of wealthy taxpayers’ holdings are in assets that are more difficult to value, suggesting greater scope for tax avoidance.

Using a different methodology, Summers and Sarin (2019a) obtained a radically lower revenue estimate for the original Warren proposal, 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% estate tax is equivalent to a 0.8% per year wealth tax. Because the estate tax raises $10 billion per year from estates larger than $50 million, they estimated that a 2% per year annual tax on wealth above $50 million 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." Saez and Zucman (2019c) forcefully argued that the $25 billion Summers–Sarin number was far too low, noting that the tax would raise more than that from the 15 wealthiest Americans alone. They argued that most assets held by the very wealthy are relatively easy to value and emphasized the enforcement provisions of the Warren proposal. Summers and Sarin (2019b) acknowledged again that upward adjustments to their $25 billion number were warranted, but insisted that the experiences with the estate and gift tax and European wealth taxes suggested that revenue would fall short of the Saez–Zucman estimate. Saez and Zucman (2019e) argued that the Summers–Sarin number was also biased downward by inaccurate assumptions about mortality rates and by a failure to account for estate tax deductions that would not be available under the wealth tax.

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 Bill Clinton and Barack 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).

According to the Saez–Zucman estimates, wealth tax revenue would be approximately 1% of GDP under the original Warren proposal and 1.6% of GDP under the Sanders proposal. Those revenue yields would be high relative to European wealth taxes. Leiserson, McGrew, and Kopparam (2019) reported that Norway's tax raises 0.4% of GDP and Saez and Zucman (2019b) noted that Spain's tax and France's former tax raised 0.2% of GDP. However, Switzerland's tax raised approximately 1% 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. On balance, it is probably reasonable to assume that revenue would fall somewhat short of the Saez–Zucman estimates. Despite Senator Warren's commendable embrace of a broad tax base, Congress would likely narrow the tax base to some extent, in accord with European practices and its own estate tax practices.

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 were apportioned, the tax rate 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 (*Hylton v. United States*). The Court ruled in 1881 that income taxes were indirect taxes that need not be apportioned even though income from real property was in the tax base (*Springer v. United States*). 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 that had to be apportioned (*Pollock v. Farmers' Loan & Trust Co.*). In later decisions, though, 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 (*Knowlton v. Moore*). 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 (*Flint v. Stone Tracy*). Of course, the adoption of the Sixteenth Amendment in 1913 made it irrelevant whether income taxes are direct. In 2012, the Supreme Court ruled that an annual tax on certain persons not covered by health insurance was an indirect tax that need not be apportioned (*National Federation of Independent Business v. Sebelius*).

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, with 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 an indirect tax that need not 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. Jensen (2003), Freeman (2019), and Khan (2019) argued that the wealth tax would be a direct tax that would need to be apportioned. Bishop-Henchman (2019) noted that the issue was unclear, but said that he was inclined to think 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 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 income 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.

It should be noted that mark-to-market taxation could also face constitutional challenges. However, mark-to-market taxation would run less risk of being struck down than a wealth tax. The challenges to mark-to-market taxation would be based on the argument that the Sixteenth Amendment's exemption of income taxes from the apportionment requirement applies only to taxes on realized income. Miller (2014) notes that most legal scholars reject this argument and concludes that the courts are unlikely to embrace it.

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 challenges. Although those challenges could probably be overcome if necessary, it may be prudent to pursue any increased taxation of the affluent 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), the *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 changes to the income tax system that they estimated would bring in $2.83 trillion over 10 years, slightly more than the Saez–Zucman estimate of the original Warren proposal'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. However, it might be desirable to go further, adopting mark-to-market taxation for capital gains on publicly traded assets and a deferral charge with taxation at death for assets that are not publicly traded, while taxing capital gains at ordinary income tax rates.

Although the changes proposed by Sarin and Summers, and other possible changes within the income tax system, would primarily be borne by affluent taxpayers, they would not fall exclusively on the very wealthiest households. Accordingly, the proposals would not break up the concentration of wealth to the same extent as the wealth taxes proposed by Senators Warren and Sanders. 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 a tiny group of extremely wealthy households.

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

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