Should the Tax System Be Used to Reduce Wealth Inequality in the United States?

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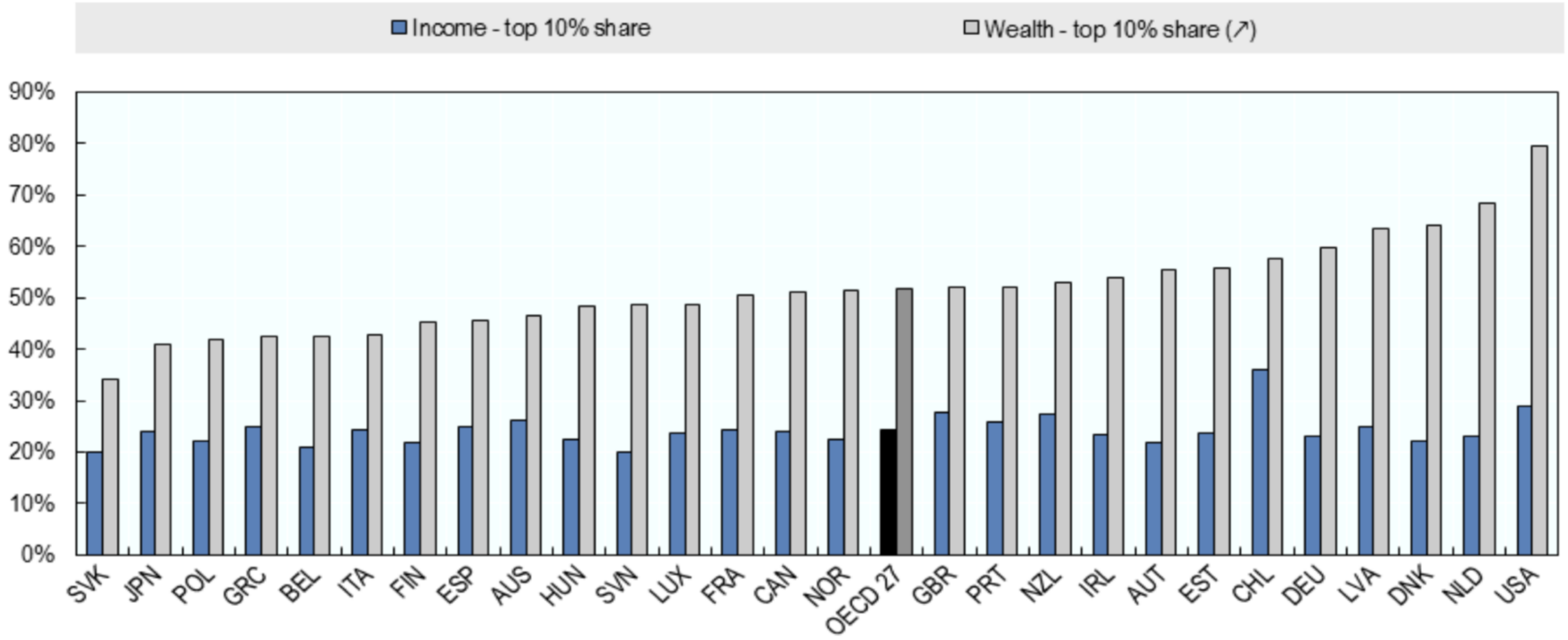
Wealth is particularly skewed in the United States—both compared with income and compared with other countries

Figure 2.9. Shares of household income and wealth held by units in the top 10 of the distribution

2015 or latest available year



Source: OECD (2018).

Rationales people have for taxing wealth/capital

1. Power to the people
2. Enjoy watching billionaires cry
3. They won’t miss the money
4. Improve the tax system

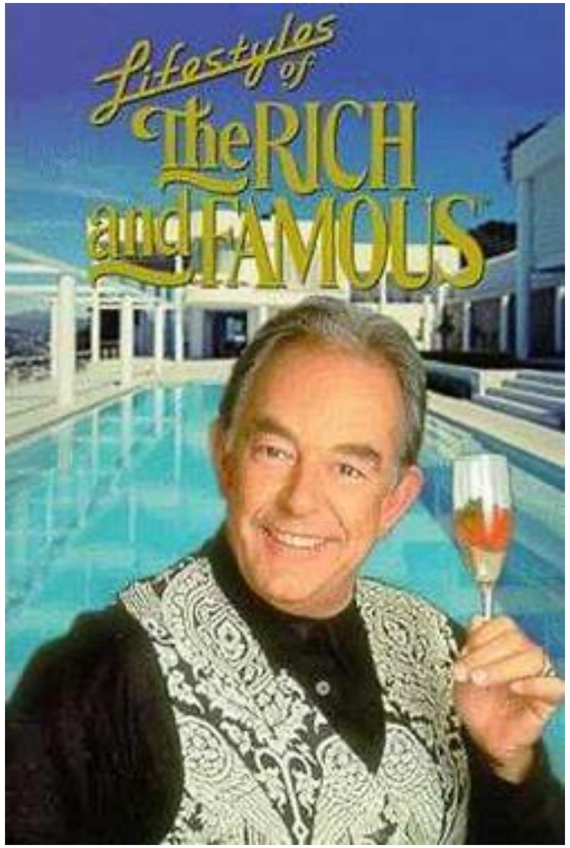
1. Evidence on power to the people?

- Lots and lots of evidence the rich have more political influence. *No evidence on whether the influence derives from absolute income or income rank*.

- What does increased capital taxation do to advocacy/political donations, which magnify the power of the rich?
    - Saez-Zucman stress the wealth effect
    - Summers stresses the substitution effect

Need to replace all the assertion in this area with actual research. Best guess is higher capital/wealth taxation has a minimal impact on political power with an indeterminate sign.

2. Evidence on billionaire tears?



Source: Wikipedia (left) and Warren campaign website (right).

Implications of the political of the externality motivations for taxes

“[Higher top rates] root justification is not about collecting revenue. It is about regulating inequality and the market economy. It is also about safeguarding democracy against oligarchy.” Emanuel Saez and Gabriel Zucman

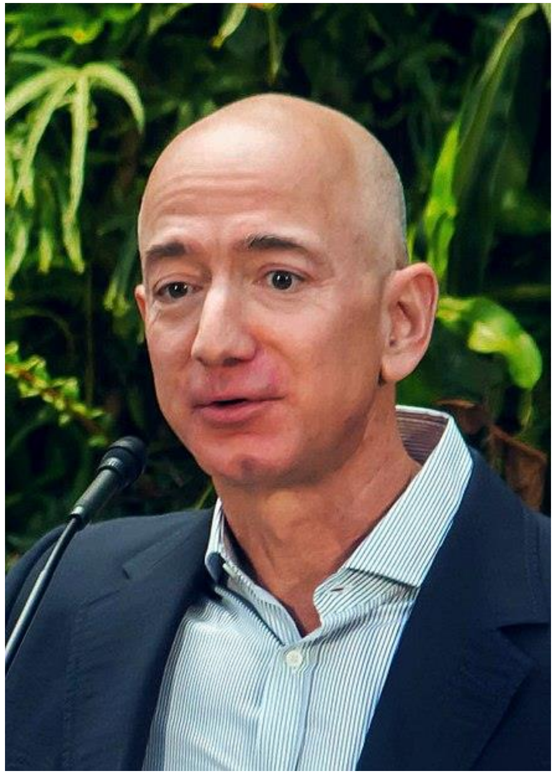
- Should tax above the revenue maximizing rate.

- Do not need to compare burdens of alternative tax systems insofar as they fall on the very rich.

- Administrative complications not a major concern and may be a plus—transfers from billionaires to accountants help democracy!

In this case, you are not in a discussion about tax efficiency—and may even want to focus on tax inefficiency.

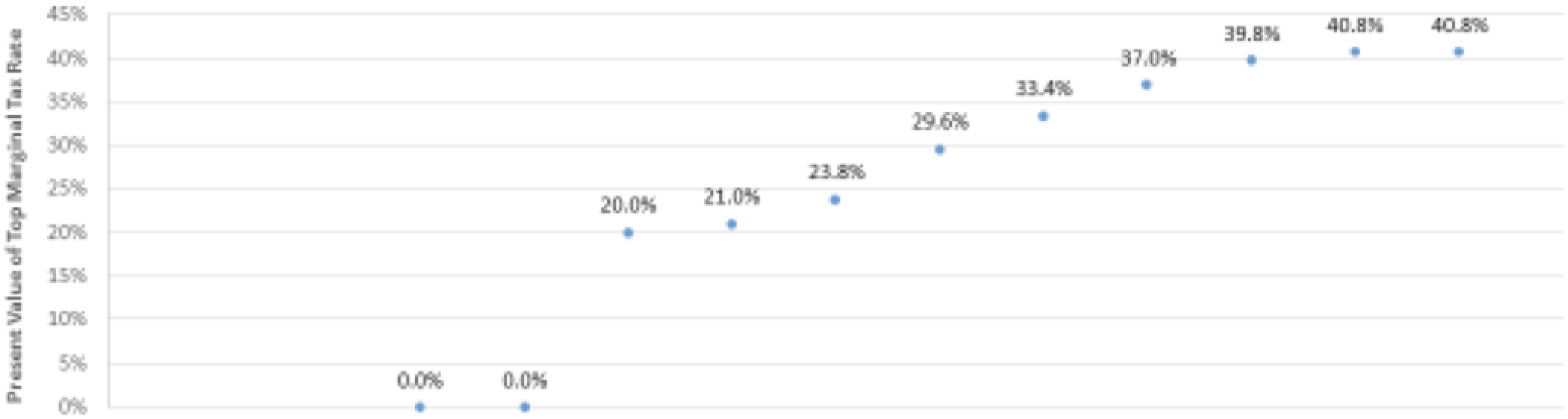
3. Who would benefit more from an additional $100?



Source: inequalitiesblog.wordpress.com (left), Wikipedia (right).

4. Variable rates implies “capital” taxation can lead to a more efficient (i.e., neutral) system

Figure 2. Present Value of Top Marginal Tax Rate by Type of Reported Income



Type of Reported Income											
W-2 income											X
Pass-through income	X		X		X	X	X	X		X	
Corporate income		X		X					X		
Defer realization indefinitely	X	X		X							
Preferential capital gains/dividends rate			X		X						
Claim 199A						X	X				
Shift profits to tax havens not s.t. GILTI		X									
SECA/NIIT loophole			X			X		X			

Source: Batchelder and Kamin (2019).

Reform options

1. **Incremental** (e.g., end step-up basis, more consistent taxation of passthrough income, change capital tax rates)

2. **Mark to market**

3. **Wealth tax** (e.g., 2 percent above $50 million, generally not integrated with other capital taxation)

4. **Integration** (e.g., Toder-Viard or Grubert-Altshuler)

Wealth tax vs. capital gains tax

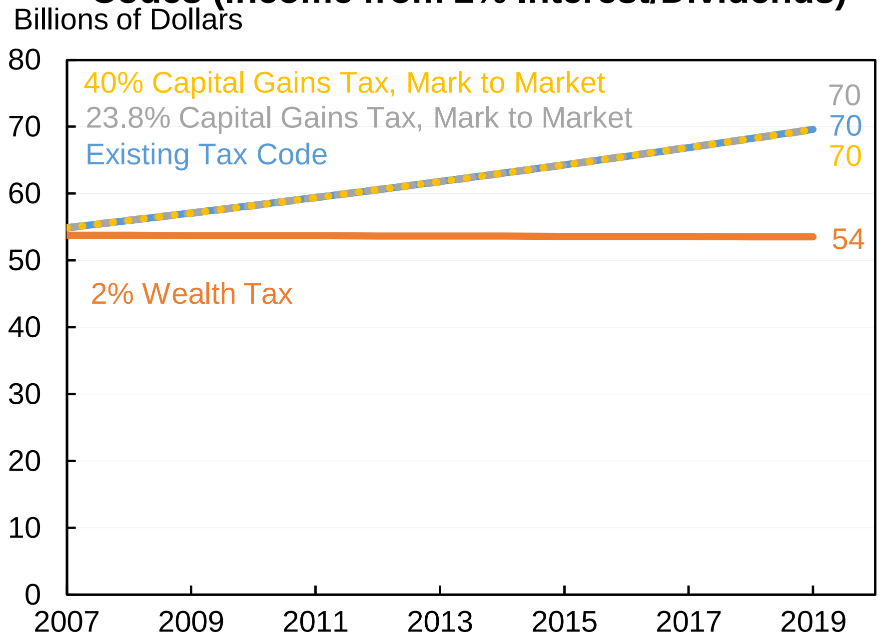
A wealth tax is a high tax rate on the “normal” return and a low or even zero tax rate on “supernormal” returns. In contrast, capital gains taxes both of them.

- **Investor in Treasuries.** Consider someone who invests in Treasuries with a 2 percent return (i.e., no “supernormal” return):
  - Wealth tax is 100 percent rate on their income
  - Capital gains tax (at ordinary rates) is a 40 percent tax rate on their income

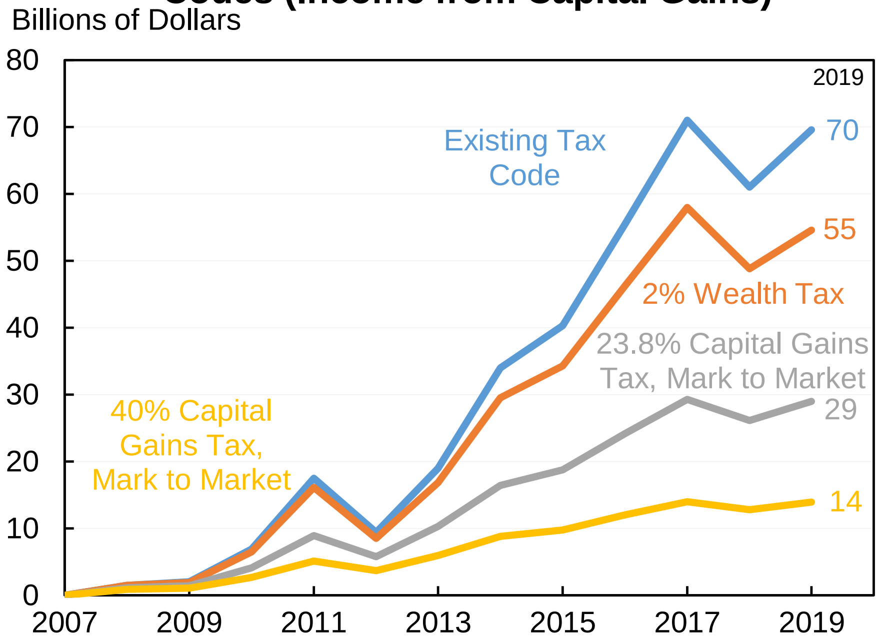
- **Successful entrepreneur.** Consider a entrepreneur/rentier/monopolist with a 50 percent return, which is mostly supernormal:
  - Wealth tax is 1 percent rate on their income
  - Capital gains tax (at ordinary rates) is a 40 percent tax rate on their income

A huge difference in wealth accumulation under the two approaches, which is more efficient and equitable?

Hypothetical Net Wealth Scenario under Different Tax Codes (Income from 2% Interest/Dividends)



Hypothetical Net Wealth Scenario under Different Tax Codes (Income from Capital Gains)



Source: Author's calculations.

Some other questions in deciding between the options

- **What are the administrative differences between the options.** All tax options imperfect, are any of them imperfecter than others?

- **Is the effort of going to MTM worth it?** Ignoring administrative costs, how much is the economic and present value revenue gain from MTM relative to constructive realization at death?

- **How do these taxes affect people who do not face them?** Under rationales 3 and 4 we want to minimize excess burden for the super-rich. Beyond that, how do these taxes affect others?

- **Are there any plausible constitutional options for a wealth tax or good ways to design a fallback?**

What I would do to individual level capital taxation

<u>If I had to pass a law today</u>:

- Constitutional Amendment to allow wealth taxation. Then decide on the merits
- Constructive realization at death
- 30 percent rate for capital gains and dividends
- Estate tax rate of 50% on a lower exemption
- Rationalize NIIT and SECA
- Eliminate carried interest and like kind
- Tighten up definitions for charitable deductions

<u>If we had two years to study the question before legislating</u>:

- Mark-to-market, potentially annually for tradeable assets and retrospectively adjusted for non-tradeable assets.

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