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The Honorable Richard Neal
Chair
Committee on Ways and Means
U.S. House of Representatives

The Honorable Kevin Brady
Ranking Member
Committee on Ways and Means
U.S. House of Representatives

The Honorable Mike Thompson
Chair
Subcommittee on Select Revenue Measures
U.S. House of Representatives

The Honorable Adrian Smith
Ranking Member
Subcommittee on Select Revenue Measures
U.S. House of Representatives

May 11, 2021

Dear Chairman Neal, Ranking Member Brady, Chairman Thompson, and Ranking Member Smith:

We write to express concerns with the Joint Committee of Taxation (JCT) staff pamphlet JCX-24-21, "Present Law and Background on the Taxation of High Income and High Wealth Taxpayers," scheduled for a public hearing before the Subcommittee on Select Revenue Measures on May 12.

This JCT pamphlet is a departure from the norm of balance and objectivity that has governed the production of such documents so far. This pamphlet relies primarily on draft estimates of income inequality produced by Gerald Auten (Treasury) and David Splinter (JCT) that are far out of the mainstream in claiming that income inequality has hardly increased since 1979.[1] The pamphlet does not warn the reader—and in fact does not even mention—that these estimates have been extensively criticized in the academic debate.

Official JCT documents play an important role in informing Congress and the public. They should not be the place to uncritically embrace and promote unvetted and controversial academic work conducted by staffers at the expense of balance and objectivity.

[1] G. Auten and D. Splinter (2019), "Income Inequality in the United States: Using Tax Data to Measure Long-term Trends," mimeo, available at http://davidsplinter.com/ Figure 1 of the JCT pamphlet essentially reproduces these estimates.

Several years after their initial draft, critical flaws with Auten and Splinter's methodology are now apparent and have been repeatedly noted:[2]

1) Auten and Splinter assume that tax evasion is primarily done by relatively low-income taxpayers, based on an erroneous reading of random audit studies. Moreover, they assume—without providing evidence—that tax evasion is *increasingly* done by relatively low-income taxpayers since the early 1990s, thus biasing trends in inequality.[3]

2) Auten and Splinter classify as tax evasion business profits earned by the top 1% that are *legally* exempt from taxes (due in particular to generous depreciation rules). This "tax evasion" is allocated primarily to relatively low-income groups—wrongly so.

3) Effective tax rates (that is, the ratio of taxes paid to income earned) for the rich are over-estimated because the income of the rich is artificially reduced. Tax rates for the poor are under-estimated because the income of the poor is artificially inflated. Specifically:
    - Auten and Splinter exclude realized capital gains from the denominator of effective tax rates, while they include taxes paid on realized capital gains at the numerator. Thus, taxpayers with large amounts of capital gains (such as hedge fund managers) have effective tax rates that can be well in excess of 100%.
    - Auten and Splinter assign business income legally exempt from taxation to the poor and the middle-class, despite the fact that this income is primarily earned by the rich. Thus, when more business income becomes legally exempt (e.g., in 2018 with the full expensing of business investment), the tax rate of the top 1% does not change—despite the fact that it should fall. The rate of the bottom 90% falls—despite the fact that it should not change.
    - Auten and Splinter inflate the income of the poor by using a flawed definition of income: pre-tax national income plus cash and in-kind transfers (e.g., Medicare, Medicaid), a total much larger than national income. This procedure double counts income for the poor and the middle class. Including Medicare and Medicaid as income at the denominator of effective tax rate computations is particularly hard to comprehend.

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[2] T. Piketty, E. Saez and G. Zucman (2019), "Simplified Distributional National Accounts", *American Economic Association: P&P*, vol. 109, p. 289-295; E. Saez and G. Zucman (2020), "Trends in US Income and Wealth Inequality: Revising after the Revisionists", NBER working paper #27921; E. Saez and G. Zucman (2020), "The Rise of Income and Wealth Inequality in America: Evidence from Distributional Macroeconomic Accounts," *Journal of Economic Perspectives*, vol. 34, n°4, p. 3-26.

[3] For instance, Auten and Splinter assume that tax evasion did not affect the top 1% income share in 1991 but reduced the top 1% income share by 0.8 points in 2015, from 17.2% before accounting for tax evasion (Auten and Splinter, 2019, Table C1-Incomes, col. DE divided by col. DB) to 16.4% after accounting for tax evasion (Auten and Splinter, 2019, Table C1-Incomes, col. DM divided by col. DJ).

For these reasons, JCX-24-21 does not provide an objective analysis of the key facts regarding inequality and the taxation of high-income taxpayers, and is not in keeping with the fine JCT tradition of producing balanced analysis to best inform Congress on important public policy issues.

Sincerely,

Emmanuel Saez and Gabriel Zucman