

Top incomes and tax policy

Emmanuel Saez and Gabriel Zucman*

Department of Economics, University of California, 530 Evans Hall #3880, Berkeley, CA 94720

*Correspondence address. E-mail: zucman@berkeley.edu

ABSTRACT

Modern tax systems do not satisfactorily tax the wealthiest individuals. Meanwhile, government revenue needs have increased in the wake of the COVID-19 pandemic. This paper discusses ideas for new revenue sources focused on the top of the distribution: A progressive tax on net wealth with a high exemption threshold, a wealth tax on corporations' stock and a one-off tax on top-end unrealized capital gains. Given the size and concentration of wealth, the revenue potential of these policies is significant.

Key words: tax; wealth; income

Introduction

Inequality has increased in many developed countries—including the United Kingdom—since the 1980s. The most striking feature has been the surge in income and wealth concentration at the top (Alvaredo et al. 2018). At the same time, the current existing tax systems in advanced economies do not do a very good job at taxing the ultrawealthy especially those who have built a fortune through a successful global business (Saez and Zucman 2019a). The corporate income taxes on business profits have shrunk due to international tax competition. The individual income tax is based on realized income and hence can be avoided as long as business shares are not sold and profits are retained with the corporation. The recent ProPublica leak of June 2021 (Eisinger et al. 2021) shows that the richest 25 Americans have paid in federal income taxes from 2014–2018 only 3.4% of their wealth gain over this period. The estate and inheritance taxes come late by definition and have also become fairly easy to avoid through aggressive tax planning and weak enforcement.

Governments worldwide have also reacted to the COVID-19 crisis with ambitious relief measures to support families and businesses funded for now primarily with public debt. Hence, it is likely that governments will seek new fiscal sources in coming years.

These developments have generated growing interest for increasing the tax burden on the very rich. In this perspective, summarizing recent research in this area, we discuss the ideas for new revenue sources focused on the top of the distribution: A progressive tax on net wealth with a high exemption threshold; a wealth tax on corporations' stock, and a one-off tax on top-end unrealized capital gains.

A modern progressive wealth tax

There is a long tradition of wealth taxation in Europe, in some cases dating back to the end of the 19th century. In recent

years, the debate on wealth taxation has gained steam following Piketty's (2014) call for a global wealth tax and evidence of rising wealth concentration in a number of countries (e.g. Saez and Zucman 2016; Alvaredo et al. 2018).

Importantly, the wealth taxes discussed today are very different from past wealth taxes. In the United States, Elizabeth Warren, in her presidential campaign, proposed in 2019 to introduce a tax on net wealth on all assets at market value above a large exemption of \$50 million per family. This contrasts with European wealth taxes that had much lower exemption thresholds—typically around \$0.5 million—and contained a long list of exemptions or preferential treatment for specific asset classes, such as closely held businesses, primary homes, works of art, etc.

Today's enforcement context is also markedly different. European wealth taxes were based on self-reported asset values. Today, tax authorities can leverage the information they receive from third parties (banks, brokers, pension funds, insurance companies, etc.). In principle, this information could be used to pre-populate wealth tax forms, reducing the need for self-reporting and thus the scope of under-reporting.

Tax authorities today automatically receive reports from foreign financial institutions, including banks located in tax havens. This stands again in sharp contrast to the situation that prevailed before the 2010s, when bank secrecy was the norm in tax havens, making offshore tax evasion easy (e.g. Zucman, 2015). Although it would be naïve to believe that this new reporting has solved offshore tax evasion entirely, it also means that enforcing a wealth tax is easier today than historically.

Modern research on tax design stresses that elasticities are not immutable parameters: with proper tax design, they can be reduced. Tax avoidance, tax competition and tax evasion are not laws of nature. For example, tax competition can be limited by taxing expatriates or using exit taxes (Saez and Zucman 2019b). Tax evasion can be curtailed with proper information collection

Received: May 5, 2023. Revised: September 7, 2023. Accepted: September 19, 2023

© The Author(s) 2024. Published by Oxford University Press.

This is an Open Access article distributed under the terms of the Creative Commons Attribution License (<https://creativecommons.org/licenses/by/4.0/>), which permits unrestricted reuse, distribution, and reproduction in any medium, provided the original work is properly cited.

(Kleven et al. 2011) and the regulation of the suppliers of tax evasion services (Alstadsæter et al. 2019).

A common issue is the question of how to value private businesses. Theory and evidence suggest that valuing private businesses is possible in countries—such as the United Kingdom—with strong property rights and developed financial sector. For example, tax authorities can apply the valuation multiples of listed firms to comparable private firms, as is commonly done in the financial industry to value private businesses in the context of mergers and acquisitions, initial public offerings, or private sales. Moreover, because the ownership of corporations is divisible (the very definition of being a shareholder), tax authorities could offer taxpayers the possibility to pay the wealth tax in kind—with shares of private businesses that could be subsequently auctioned (Saez and Zucman 2019a).

A tax on corporations' stock

Saez and Zucman (2021a) propose a new instrument to complement the measures envisioned to share the financial cost of the COVID-19 pandemic: a tax on corporations' stock shares for all publicly listed companies. Each company would have to pay a certain percentage—e.g. 0.2%—of the value of its stock in taxes each year. The securities commissions in each G20 country (which already supervise the creation and transactions of equity securities) could administer the new tax.

Because the UK stock market capitalization adds up to about 125% of UK GDP, a tax at a rate of 0.2% would generate about 0.25% of GDP in revenue. Despite having a flat rate, this would be a progressive tax, because stock ownership is highly concentrated among the rich. In the United States, for example, the top 1% adults with the highest pre-tax income own about 30% of all publicly-traded corporate equities (including corporate equities indirectly held through pension plans and insurance funds).

Like all taxes on capital, such a tax would be best implemented in a coordinated manner, for instance at the G20 level. As the G20 stock market capitalization is around \$90 trillion, or about 90% of the G20 countries' GDP of \$100 trillion, the tax would raise approximately \$180 billion each year, approximately 0.18% of the GDP of the G20. The G20 would also be the ideal institution to negotiate the creation of such a tax and decide how its proceeds should be allocated between member countries. A number of allocation schemes can be considered: the proceeds could be allocated among G20 countries or globally (including to non-G20 countries), proportionally to population, to the amount of sales made in each country, to the value of the tangible capital stock, and to a combination of these (and other possible) factors.

Because the tax rate is low (only 0.2%) and G20 countries are in need of tax revenue due to the large increase in public debts due to the COVID-19 crisis, it is conceivable that most or all of G20 countries could agree to such a tax in the foreseeable future.

A one-off tax on the stock of unrealized capital gains

Capital gains currently can escape taxation for decades and often forever, as the wealthy wait to sell their stock and other assets. To address this issue, Saez and Zucman (2021b) propose to tax the unrealized capital gains of billionaires. Concretely, all the unrealized capital gains of billionaires could be deemed realized on a certain date. Once deemed realized, these gains would be subject to the individual income tax—just like regular capital gains, but in this case with payments spread over 10 years.

Such a tax on the stock of unrealized gains would be a simple way to tax 'above-normal' returns. It would be hard to avoid, as governments have information about the wealth of billionaires, which are highly visible in the public debate and own large businesses which already fill tax forms. Information on billionaire wealth includes the annual income tax returns and balance sheets of the businesses they own, and daily estimates compiled by Forbes and Bloomberg.

For economists, a tax on the stock of unrealized capital gains is appealing because it does not distort behavior. The gains have already been made, therefore, the traditional argument that taxation discourages effort and innovation becomes moot, at least if the government can credibly commit that this is a one-off tax.

From a revenue perspective, a one-off tax on the stock of unrealized capital gains would raise substantial sums given the increase in billionaire wealth during the COVID-19 pandemic. Saez and Zucman (2021b) offer a scoring in the US context. According to Forbes, US billionaires owned \$4.26 trillion on April 1 of this year, of which unrealized gains accounted for more than \$2.5 trillion, by our calculations. A one-time tax on the unrealized gains of billionaires at a rate of 40% would thus generate \$1 trillion.

This solution usefully complements proposals to increase the taxation of realized capital gains, since it would prevent billionaire from avoiding this tax increase by deferring realizations. The tax on the stock of unrealized gains can also be constructed as a pre-payment of future realized gains taxes, preventing deferral of these taxes.

Although these ideas have received particular interest in the US context, they could be applied in many other countries where there are well defined property rights and developed financial markets, which make the valuation of private wealth (and of its rise) possible.

ACKNOWLEDGEMENT

We thank Richard Blundell and Angus Deaton for helpful discussions and comments. We acknowledge funding from the Berkeley Center for Equitable Growth and the Berkeley Stone Center on Wealth and Income Inequality.

FUNDING

This commentary was written for the IFS Deaton Review of Inequalities, funded by the Nuffield Foundation (grant reference WEL/43603). The views expressed are those of the authors and not necessarily the Foundation.

REFERENCES

- Alstadsæter, A., Johannesen, N., and Zucman, G. (2019) 'Tax Evasion and Inequality', *American Economic Review*, **109**: 2073–103.
- Alvaredo, F. et al. (2018) *The World Inequality Report 2018*, Cambridge: Harvard University Press.
- Eisinger, J., Ernsthäuser, J., and Kiel, P. (2021) 'The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax', *ProPublica*, June 8, 2021.
- Kleven, H. et al. (2011) 'Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark', *Econometrica*, **79**: 651–92.
- Piketty, T. (2014) *Capital in the 21st Century*, Cambridge, MA: Harvard University Press.

- Saez, E., and Zucman, G. (2016) 'Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data', *Quarterly Journal of Economics*, **131**: 519–78.
- Saez, E., and Zucman, G. (2019a) *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make them Pay*, New York: W. W. Norton.
- Saez, E., and Zucman, G. (2019b) 'Progressive Wealth Taxation', *Brookings Papers on Economic Activity*, Fall, **2019**: 437–533.
- Saez, E., and Zucman, G. (2021a) 'A Wealth Tax on Corporations' Stockdraft April 2021 prepared for', *Economic Policy*.
- Saez, E and Zucman, G. (2021b). "How to Get \$1 Trillion from 1000 Billionaires: Tax their Gains Now" draft April 2021.