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TO: ZACHARY Q. JACKSON, INDIANA STATE BUDGET DIRECTOR
FROM: JACOB ALDER, TAX ANALYST
DATE: APRIL 12, 2022
RE: WEALTH TAX IN AMERICA

Wealth inequality in America today has profound impacts on society and democracy. This memorandum summarizes the current "wealth tax" debate about taxation of unrealized capital gains in the United States and walks through five contours of the discussion: (1) Economic efficiency, (2) Equity, (3) Transparency, (4) Collectability, and (5) Adequacy. I introduce the memo with a brief historical review and conclude with an economist's perspective.

HISTORY

Recent wealth tax proposals in the U.S. share an intellectual origin: French economist Thomas Piketty's 2014 *Capital in the 21st Century.* Piketty's landmark book illustrated the danger of extreme inequality in society and compares the present-day U.S. to pre-revolution France. Remarkably, the gap today between the wealthiest individuals and the poorest individuals is greater now than at any point in time leading up to, or after the French Revolution. Unlike the 1780s, the nation's wealthiest individuals today hold the vast majority of their wealth in stock equity—unrealized assets that the U.S. tax system cannot reach until they are sold. This, Piketty argues, makes the U.S. ripe for class conflict, even revolution.

CURRENT BIDEN PROPOSAL

On March 28, 2022, President Joe Biden announced a tax on "extremely wealth taxpayers" to take effect for the FY 2023 budget.[1] The Biden Administration's proposal would close several loopholes that allows unrealized capital gains to entirely avoid taxation. The proposal would increase the top marginal income tax rate for high earners, reform capital income taxes, and impose a minimum income tax on the wealthiest taxpayers. The Office of Management and Budget (OMB) estimated that the minimum income tax will raise over $360 billion in revenue over 10 years, and the combined tax reform will raise over $720 billion over 10 years.[2]

ORIGINS OF THE WEALTH TAX PROPOSALS IN THE U.S.

President Ronald Reagan famously cut taxes rates for wealthy individuals in the 1980s. In the subsequent four decades, inequality in the U.S. grew sharply. During the 2020 U.S. presidential election season, several candidates including, most notably, Senator Elizabeth Warren (D-MA), campaigned in large part on the notion of increasing taxes on the wealthiest 75,000 American households—the "ultra-millionaire tax." Sen. Warren did not win the election, but her wealth tax brought the idea to mainstream conversation. President Biden's proposed wealth tax draws intellectual origins from Sen. Warren's proposal.[3]

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[1] U.S. Department of the Treasury. "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals." https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf

[2] *Id.* Table 1.

[3] Marchese, David. "Thomas Piketty Thinks America Is Primed for Wealth Redistribution." *New York Times*, New York: New York Times Company. Apr 3, 2022.

Two of Piketty's colleagues, both professors at U.C. Berkley, worked with Elizabeth Warren to develop her progressive wealth tax proposal. Sen. Warren proposed to tax American households with a net worth above $50 million.[4] The tax would be 2% on the net worth above $50 million and an additional 1% tax on net worth above $1 billion. Emmanuel Saez and Gabriel Zucman, the UC Berkley economists, estimated the tax would raise $2.75 trillion over the ten-year budget window 2019-2028. Compared to President Biden's proposed tax, Sen. Warren's reaches further and could potentially have raised nearly ten times the projected OMB estimate.

Economic efficiency

In either case, a tax on wealth would certainly affect economic behavior. On its face, a wealth tax certainly discourages accumulation of financial capital. To determine whether or not a wealth tax is economically efficient, administrators need to balance collectability and revenue generation, which requires evaluating the entire fiscal scheme. Intangible wealth poses a real challenge: it is a slippery base (Adam and Miller, 2021). For example, administrators might consider the marginal return of collecting each additional dollar (or million dollars) from a monied and adept hedge fund manager, who quietly moves her money to multiple shell companies in tax havens across the U.S. or abroad. Affected high-wealth taxpayers will likely try to liquidate, redistribute, or otherwise hide their assets to avoid paying the taxes (Troup et al., 2021).

Equity

Most politicians, including President Biden and Sen. Warren, who advocate for a wealth tax argue that the level of inequality merits the tax on capital assets. This does not necessarily mean that a wealth tax will eliminate inequality. However, a wealth tax takes aim to increase the vertical equity in the tax system through wealth redistribution. In a recent conversation with New York Times columnist David Marchese, Piketty explained that:

> All wealth is collective by nature in the sense that it relies on the work of hundreds, thousands, millions of engineers, technicians, the accumulation of knowledge. Then, private property is a social construction that we invent in order to organize economic and social relations. It's a very useful social invention as long as you keep under control how much you can accumulate, how much power you can concentrate, etc. But none of these assets are their assets. They are a product of a collective process. No one invented anything by himself or herself.[5]

As Piketty noted, the notion of wealth is a socially constructed one. So too, is a tax on wealth. By its nature, a tax on unrealized capital gains is progressive; whether or not society endorses it depends on the collective view individuals take on wealth redistribution.

Transparency

A wealth tax severely lacks transparency, since unrealized gains are subject to extensive speculation.[6] High-wealth individuals also store wealth in luxury items like art and jewels, which are difficult to appraise unless brought to auction. However, these factor into an individual's net worth and would theoretically be subject to the proposed tax. Emma Chamberlain wrote about

[4] Sum of all assets net of debts. Saez and Zucman estimate that

[5] Marchese, David. "Thomas Piketty Thinks America Is Primed for Wealth Redistribution." *New York Times*, New York: New York Times Company. Apr 3, 2022.

[6] Consider, for example, the individuals who became overnight millionaires during the GameStop and AMC Theaters trading frenzy. Investor speculation drove stock prices to unprecedented heights and ran at least one hedge fund, which had shorted the stock, into bankruptcy. See: "London-Based Hedge Fund Closes After Betting Against Gamestop." June 22, 2021. https://www.forbes.com/sites/roberthart/2021/06/22/london-based-hedge-fund-closes-after-betting-against-gamestop-becoming-one-of-first-meme-stock-casualties/

wealth taxes in seven OECD countries and underscored the low transparency argument, from the perspective of trusts—another form of capital asset class wealthy individuals use to shield wealth from taxes (Chamberlain, 2021).

Collectability

For the aforementioned reasons, wealth tax administration and remittance poses severe challenges to the IRS as currently constituted; at one point, Biden floated the idea of hiring 87,000 new IRS employees over ten years. In its current proposal, however, the Biden Administration decided it will value only "tradable" assets, like stocks, based on the stock's value as of December 31 of the calendar tax year.[7] It will also extend the determined period for reporting on transactions to allow the IRS more time to investigate cases.[8] Sen. Warren did not propose how she would value and collect the taxes, but would leave it to the various agencies to decide.

Adequacy

Scholars agree that if a wealth tax generates sufficient revenue in excess of both the administrative costs and the economic impacts associated with behavioral changes, then it meets the adequacy threshold. The OMB estimates that the Biden Administration's tax proposal, as noted earlier, will generate upwards of $260 million, or $720 million over ten years.

Concluding Perspective

Taxation on unrealized capital gains requires real effort. Saez and Zucman, at least are convinced that improved data combined with political willpower make the tax a real possibility. The success, or failure of such a tax will, they argue, determine the future of American democracy. In any case, developing a concrete and comprehensive wealth tax offeres real benefits because it targets wealth concentration at the "stock, rather than the flow" (Saez and Zucman, 2019).

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[7] *Biden Tax Plan* at 35.

[8] *Id.* at 75.