Inequality

The IFS Deaton Review

Top incomes and tax policy

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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 ultra-wealthy, 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 realised income and hence can be avoided as long as business shares are not sold and profits are retained with the corporation. The *ProPublica* leak of June 2021 (Eisinger, Ernsthausen and Kiel, 2021) shows that the richest 25 Americans have paid in federal income taxes from 2014–18 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, summarising 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 unrealised 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 the call by Piketty (2014) for a global wealth tax and following 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.

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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 (Kleven et al., 2011) and the regulation of the suppliers of tax evasion services (Alstadsæter, Johannesen and Zucman, 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 UK, with strong property rights and a 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 capitalisation 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 US, 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 capitalisation 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 unrealised 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 unrealised capital gains of billionaires. Concretely, all the unrealised capital gains of billionaires could be deemed realised on a certain date. Once deemed realised, 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 unrealised 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, who are highly visible in the public debate and own large businesses that already fill out 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 unrealised capital gains is appealing because it does not distort behaviour. The gains have already been made; therefore, the traditional argument that taxation discourages effort and innovation becomes moot.

From a revenue perspective, a one-off tax on the stock of unrealised 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 1 April 2021, of which unrealised gains accounted for more than $2.5 trillion, by our calculations. A one-time tax on the unrealised gains of billionaires at a rate of 40% would thus generate $1 trillion.

This solution usefully complements proposals to increase the taxation of realised capital gains, as it would prevent billionaires from avoiding this tax increase by deferring realisations.

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