The California Extreme Wealth Tax: Revenue, Economic, and Constitutional Analysis

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The proposed bill would impose an annual tax of .4% of extreme wealth defined as wealth in excess of $30 million per taxpayer. Wealth includes worldwide assets (but excludes real estate property). CA residents who leave the state would be liable for the tax for up to 10 years (with a decreasing fraction of their wealth taxable after leaving). New CA residents would symmetrically be liable on a progressively growing fraction of their wealth in their first 10 years of residence. We estimate that about 30,000 CA families (top .15%) would be liable for the extreme wealth tax and that the tax would raise about $7.5 billion/year. The wealth tax would help with the current fiscal crisis, reduce wealth concentration, and improve tax justice.

Inequality and tax fairness

California today has 12% of the US population but 17% of all US millionaires and 25% of all US billionaires.[1] In 2011, California had only 15.5% of all US millionaires and 21% of all US billionaires. Therefore, the California share of US millionaires and billionaires has been increasing over the last decade even though California increased its tax on millionaires in 2012.[2] Income and wealth is more concentrated in California than in the US overall and this concentration has been growing faster.[3] The covid crisis further exacerbates inequality: the working class struggles with job and income loss while the rich can generally keep working from home. California billionaires' wealth has already fully bounced back and even surpassed pre-covid levels. The collective wealth of California billionaires has surged to $924 billion on July 29, 2020. It was $706 billion in March 2019, a year before the covid crisis started and only about $300 billion in 2011.[4]

While the income tax is successful at taxing millionaires, it is not very effective at taxing the ultra-wealthy who do not need to realize their incomes.[5] For example, Mark Zuckerberg, the richest Californian, can avoid the CA income tax as long as he does not sell his Facebook stock. This is the main weakness of the CA tax system. The wealth tax directly remedies this injustice by taxing all wealth, whether this wealth has been realized as income or not. With the wealth tax, Zuckerberg would have to pay .4% of his $85 billion wealth, that is $340 million, even if he does not realize gains by selling stock.

[1] The CA and US populations are 39.5m and 331.8m in 2019. The IRS compiles individual income tax statistics by state. In 2016 and 2017, the last 2 years available, CA millionaires were 16.8% and 16.7% of all US millionaires. As of July 29, 2020, there were 165 CA billionaires out of 647 US billionaires (25.5%) on the Forbes billionaire list.

[2] The CA share of the US population has been stable during this decade from 12.08% in 2011 to 12.04% in 2019.

[3] The top 1% income share is higher in CA than US wide in recent years (e.g., 25.5% vs. 22% in 2015) but was the same in the 1980s (e.g., 9.9% vs. 10.0% in 1980). See https://www.shsu.edu/eco_mwf/inequality.html

[4] See the Forbes billionaire list.

[5] Saez and Zucman (2019), *The Triumph of Injustice*, Norton estimate that the effective tax rate on billionaires (combining all taxes at the federal, state, and local levels) relative to their true economic income is only 23% in 2018 (while it is 28% economy wide).

The wealth tax would in the long run help reduce wealth concentration. For example, after 10 years of tax at a .4%, the wealth of a billionaire would be reduced by about 4%. After 20 years, the reduction would be about 8%. This is not radical but still a valuable step (the Elizabeth Warren "2 cents" wealth tax rate was 5 times higher than this .4% tax). The California constitution currently limits the tax rate on net worth to .4%.

Revenue analysis

We estimate that the extreme wealth tax of .4% above $30 million would generate $7.5 billion in additional revenue per year for the State of California. About 30,000 CA families (top .15% richest families) would be liable for the tax. These revenue estimates are made using Californians on the Forbes 400 billionaire list for 2019 combined with the US wide Survey of Consumer Finances (and assuming that 17.5% of wealthy Americans reside in California, consistent with IRS tax data on CA millionaires). We have also assumed a tax evasion rate of 20% that is slightly higher than the 15% evasion rate for income and corporate taxes (as estimated by the IRS) and is realistic given the strong enforcement measures included in the bill.

The table attached at the end shows how revenue estimates and number of families liable would change with alternative exemption thresholds from $10 million to $1 billion. The California constitution currently limits the tax rate on net worth to .4%.

Economic impacts

Will ultra-wealthy CA residents leave the state?

As mentioned above, the California share of all US millionaires and billionaires has increased over the last decade in spite of the 2012 high income surtax. Therefore, we are still far from a tipping point. The wealth tax bill is also structured in such a way CA wealthy residents who leave still have to pay the extreme wealth tax on a fraction of their wealth for up to 10 years: they pay tax on 90% of their wealth the year after they leave, on 80% 2 years after they've left, .. , on 10% 9 years after they've left, 0% 10 years or more after they've left. The logic is that wealth is the fortune you built over a lifetime and hence a wealth tax requires looking beyond the current year. This makes the wealth tax much harder to avoid than the income tax (where you are no longer liable after leaving the state).

Will ultra-wealthy be deterred from coming?

Symmetrically, the wealth tax kicks in progressively for new residents. They pay tax on only 10% of their wealth in their first year, on 20% in their second year, … , on 100% only after 10 years. Therefore, the wealth tax is extremely modest for wealthy newcomers who built their fortune outside of California.

Will entrepreneurs be discouraged?

The wealth tax allows entrepreneurs whose wealth is tied up in a private business (e.g., a very successful start-up whose stock does not trade publicly yet) to defer payment so that the wealth tax does not interfere with business decisions. The deferred payment is set up to be paid upon stock sale or issuance exactly as if the entrepreneur had paid .4% of her business stake in taxes each year. For example, an entrepreneur who sells her start-up for $1 billion after having deferred the wealth tax for 5 years would owe approximately a 2% wealth tax on her sale (5 times .4%).

Won't the wealthy be able to hide their wealth and evade the tax?
The bill includes a number of strong provisions to make evasion quite difficult. The wealth tax base is comprehensive with no exclusions.[6] Owning wealth indirectly through trusts or corporate shells cannot reduce valuations for wealth tax purposes. Offshore financial wealth is already reported to the IRS by both owners and foreign institutions. Subsequent sales of assets at prices higher than previously reported will generate ex-post adjustments. There are penalties for under-reporting wealth.

Increasing taxes during a recession?
Higher taxes depress the economy in the short-term if they reduce spending. But the rich are now piling up income they cannot spend (as the crisis limits spending opportunities). Therefore, an extra tax would not cut their spending. Lower government spending however would for sure negatively affect the economy. Borrowing from the rich or taxing the rich is imperative to fight the recession. Unfortunately, states cannot borrow through public debt and it does not look like the federal government (which can borrow at almost zero interest rate) will help the states in the near future. If California cannot borrow nor receive federal support, then taxing the rich to preserve essential public spending is the best option to limit the economic damage of the crisis.

Constitutionality Issues

The extreme wealth tax was carefully designed to stay clear of constitutional issues. Here are the most often asked questions on this:

Is it constitutional for California to tax worldwide wealth of residents?
In the same way the CA income tax applies to CA residents on their worldwide income, the CA wealth tax can, with exceptions the bill respects, apply on worldwide assets.

Does the extreme wealth tax respect Proposition 13 tax limitations?
Yes, the wealth tax excludes real estate property directly held from taxation. For real estate indirectly held (through a trust or business), the wealth tax offers a credit for any property tax paid (up to .4% of the value of the real estate).

Does the federal constitution allow states to tax wealth?
Yes, states have wide latitude to set their tax systems so long as, speaking generally, there is not double taxation. Accordingly, the wealth tax provides credits for any similar wealth taxes levied on taxpayers by other jurisdictions.

Can California implement a more progressive wealth tax with graduated rates?
The California constitution currently limits the tax rate on net worth to .4%. Therefore, it is not possible to go beyond .4% without amending the constitution.

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[6] Real estate property directly held is excluded but it already pays a property tax that is in most cases higher than the extreme wealth tax rate of .4% (especially for recently bought property).

Revenue estimates from CA Extreme Wealth Tax (in 2019 $) for various exemption thresholds

	Exemption threshold (for married couple taxpayer)	Exemption threshold (for single taxpayer)	Base above exemption in $billions	Number of taxpayers	Share of CA families liable	Tax rate (.4% = constitu-tional max)	Tax revenue in $billions (per year)
A. Same exemption threshold for all taxpayers (whether married or single) as in Elizabeth Warren wealth tax							
	$20 million	$20 million	2271	51,410	0.24%	0.4%	9.1
CURRENT BILL	**$30 million**	**$30 million**	**1874**	**30,443**	**0.14%**	**0.4%**	**7.5**
	$50 million	$50 million	1547	9,674	0.045%	0.4%	6.2
	$100 million	$100 million	1213	4,891	0.023%	0.4%	4.9
	$200 million	$200 million	929	1,500	0.0070%	0.4%	3.7
	$1 billion	$1 billion	596	135	0.00063%	0.4%	2.4
B. Exemption threshold halved for taxpayers who are not filing married jointly as in Bernie Sanders wealth tax							
	$20 million	$10 million	2341	65,133	0.30%	0.4%	9.4
	$30 million	$15 million	1927	33,360	0.16%	0.4%	7.7
	$50 million	$25 million	1594	11,443	0.053%	0.4%	6.4
	$100 million	$50 million	1262	5,418	0.025%	0.4%	5.0
	$200 million	$100 million	967	2,097	0.010%	0.4%	3.9
	$1 billion	$500 million	599	177	0.00083%	0.4%	2.4

Notes: This table displays estimates for the state of California of the tax base, number of taxpayers, fraction of CA families liable, tax rate, and tax revenue for various exemption thresholds for the tax on extreme wealth. Estimates are for 2019 (scale estimates by size of CA economy in future years). The wealth tax is a tax on the total worldwide net worth excluding real estate property of CA families. The table shows estimates for various exemption thresholds. In panel A, the exemption threshold is the same for married and non-married taxpayers (as in Elizabeth Warren proposed wealth tax). In panel B, the exemption threshold is halved for non-married taxpayers (as in the Bernie Sanders wealth tax). Revenue is the same in the short and long-run (relative to size of the economy). The CA constitution currently imposes a .4% limit on the wealth tax rate. Estimates are based on the Survey of Consumer Finances (scaled to California) and the Californians on Forbes 400 billionaires list in 2019. We assume a 20% tax avoidance/evasion rate which is realistic given the robust proposed enforcement. Calculations made by Professor Emmanuel Saez, UC Berkeley. The current proposed bill has a $30 million exemption (same for married and single taxpayers) and is depicted in bold in panel A.