Rethinking Capital and Wealth Taxation

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Introduction

Optimal tax equity-efficiency tradeoff starker for capital

Capital income and wealth are always highly concentrated (much more so than labor income)

Wealth concentration has increased in most countries

Private wealth (relative) to GDP has increased sharply

Variety of taxes on capital: property tax, wealth tax, inheritance tax, individual income tax on some capital income flows, corporate tax on profits

Yet overall tax systems in OECD countries remain regressive at the top [measured as tax/income]

Figure 1. Average tax rates by income group: US, France, Netherlands

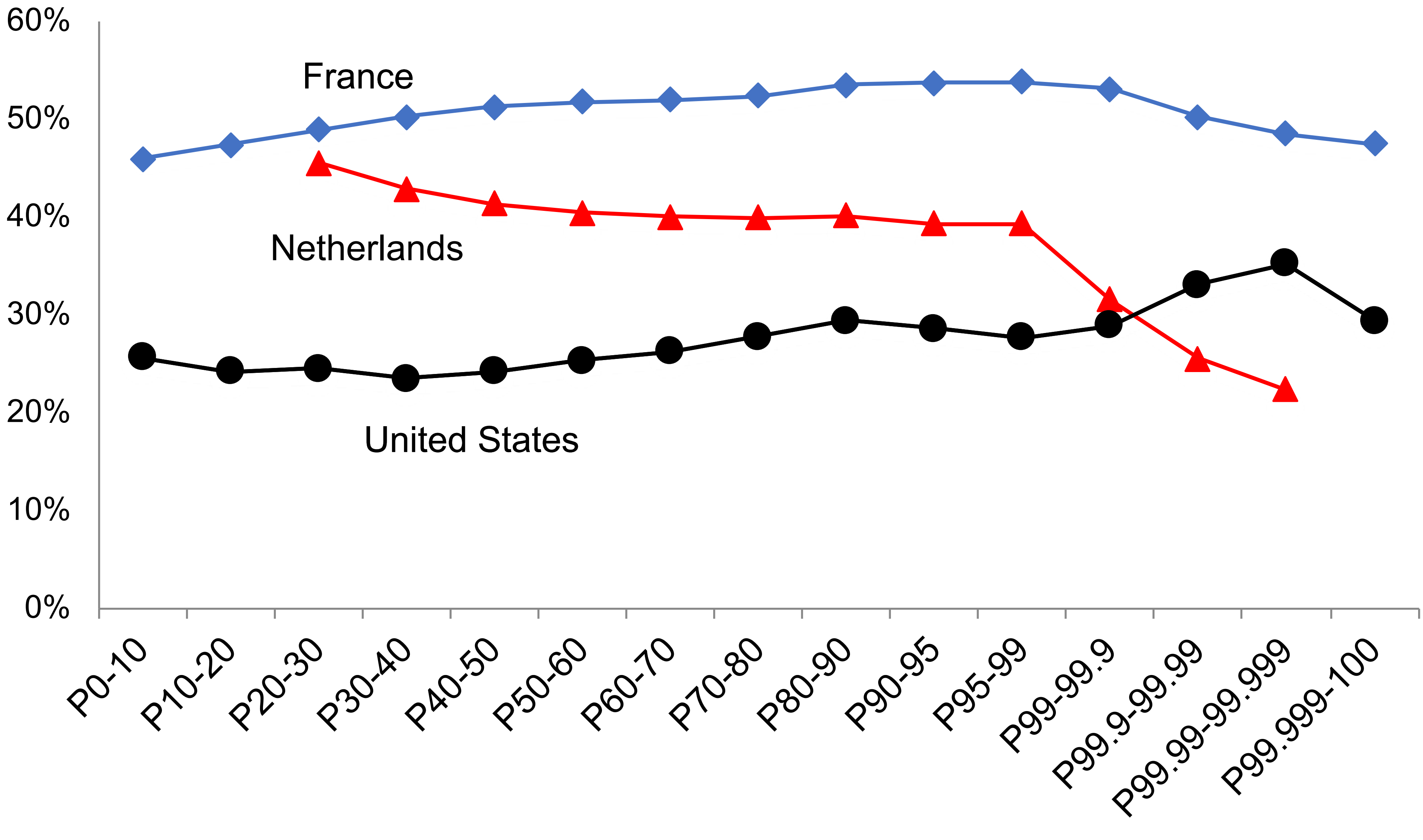
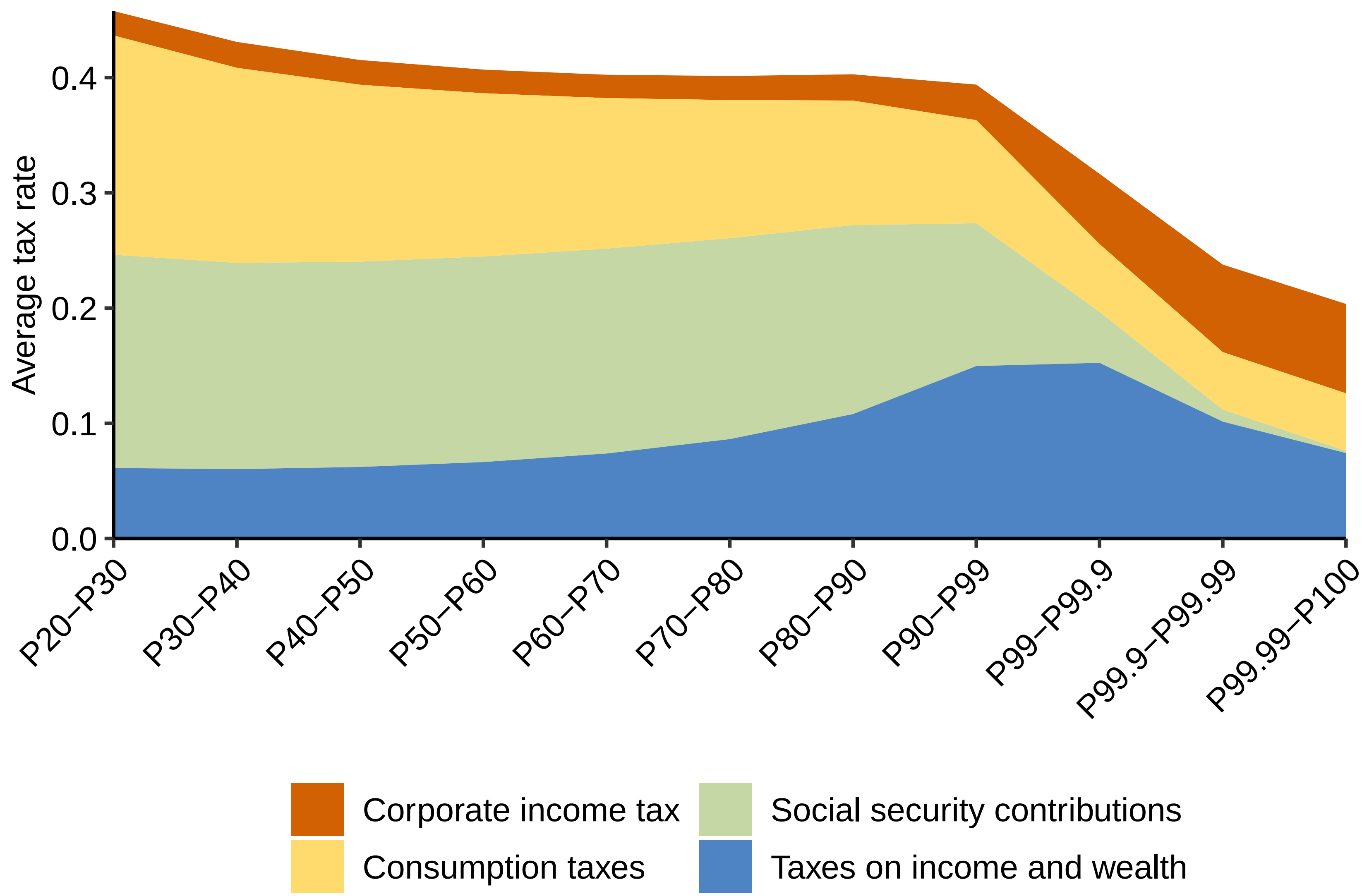


Figure 7: Tax rate by income group and type of taxes



Source: Bruil et al. 22. Netherland tax system is regressive at the top of income distribution

Theory and Practice of Capital Taxation

Our paper selects three main theoretical results/research avenues most relevant in practice

(1) Fuzzy frontier between labor and capital income
$\Rightarrow$ **Tax comprehensive income**

(2) Income tax fails at taxing asset gains of ultra-rich
$\Rightarrow$ **Add a top wealth tax**

(3) Inherited wealth less deserved than self-made wealth
$\Rightarrow$ **Add inheritance tax**

Our paper confronts this **ideal tryptic** with practice

(1) Tax Comprehensive Income

Equity: Fair to assess taxes on total income

Efficiency: Tax differentials across bases can generate shifting

Shifting responses dwarf real responses (Slemrod's hierarchy)

At the top: ways to shift labor income into capital income

Self-employed/entrepreneurs can incorporate to earn "profits"

Executives can be paid in stock

$\Rightarrow$ Tax comprehensive income = labor + capital income

$\Rightarrow$ Integrate corp tax with income tax (US passthrough model)

(2) Add Progressive Wealth Tax at the Top

New billionaires can escape comprehensive income tax because their fortune is made of asset gains (not yet income flows)

In practice: capital gains taxed only upon realization and at preferential rates

Haig-Simons income tax base $= \Delta$Wealth - Consumption unpractical due to volatility

$\Rightarrow$ Progressive annual wealth tax is the only proven way to tax billionaires

Consumption smoothing irrelevant. Is it good or bad to dilute founders-owners faster?

Need more reduced form models of wealth accumulation and taxation (Blanchet '22)

(3) Add Inheritance Tax for Meritocratic Reasons

Inherited wealth is "less deserved" than self-made wealth

But inheritance tax hurts both inheritors and donors

Piketty-Saez '13: maximize welfare of zero receivers:

$$\textbf{Meritocratic optimum:} \qquad \tau_B = \frac{1-\bar{b}}{1+e_B}$$

e_B elasticity of inheritances with respect to $1-\tau_B$

$\bar{b}$ = bequests left by zero receivers relative to average $\simeq$ 50%

Inheritance tax powerful in dynastic environments (Europe pre 1914) but limited when self-made wealth prominent (US today) $\Rightarrow$ Wealth tax more powerful (Blanchet '22)

Structure of Modern Progressive Taxation

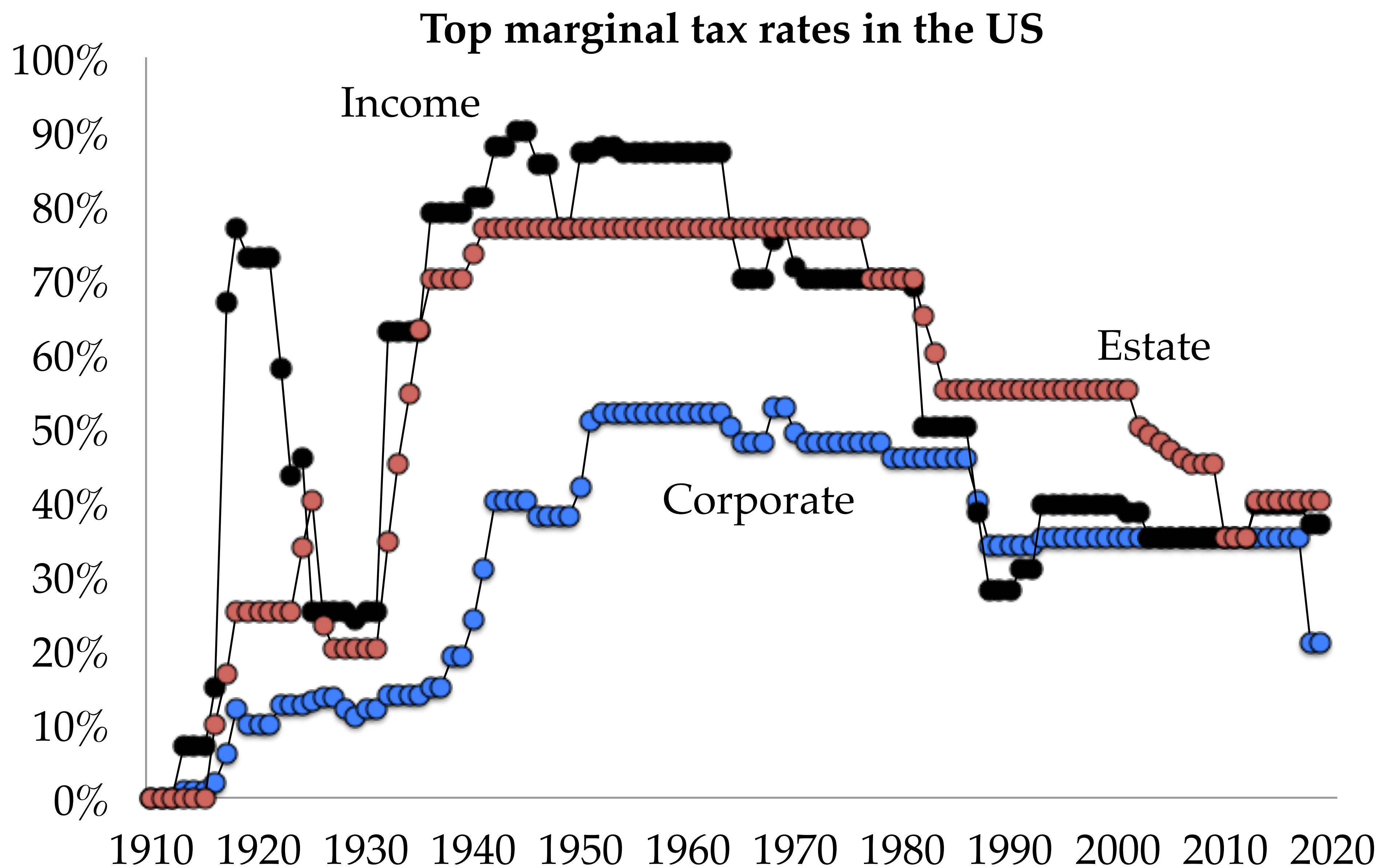
Advanced economies developed modern progressive taxes around 1900 with three pillars:

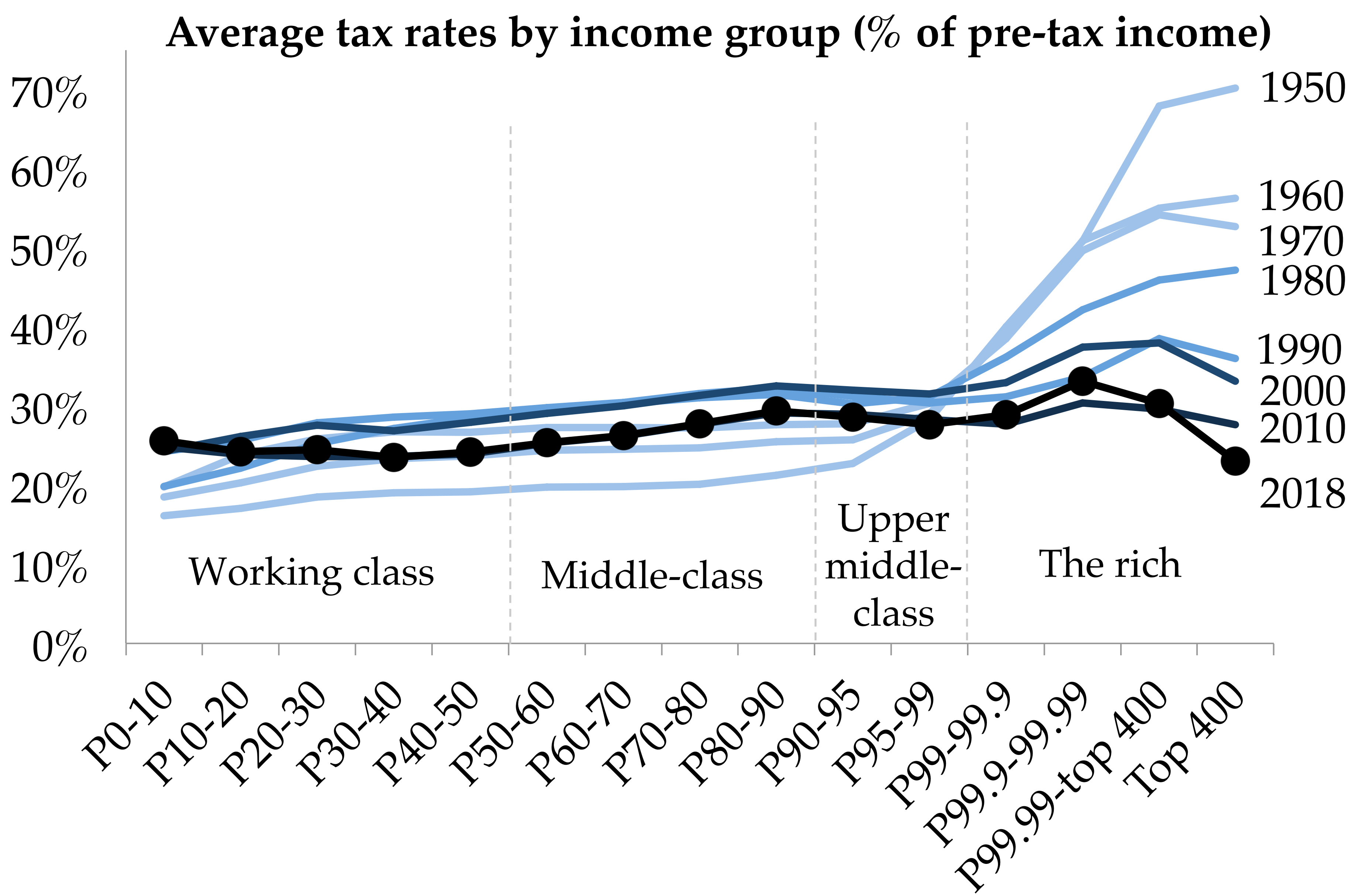
a) Progressive individual income tax on comprehensive income

b) Corporate tax on profits (flat tax rate at source)

c) Progressive inheritance tax (to prevent dynastic wealth) + Progressive annual wealth taxes (in some countries)

Enforceable even 100 years ago because top income and wealth comes primarily from large formal businesses (divisible in shares)


Top marginal tax rates in the US
Income
Estate
Corporate
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010
2020


Average tax rates by income group (% of pre-tax income)
70%
60%
50%
40%
30%
20%
10%
0%
1950
1960
1970
1980
1990
2000
2010
2018
Working class
Middle-class
Upper middle-class
The rich
P0-10
P10-20
P20-30
P30-40
P40-50
P50-60
P60-70
P70-80
P80-90
P90-95
P95-99
P99-99.9
P99.9-99.99
P99.99-top 400
Top 400

Demise of Progressive Taxation in Last 50 Years

Let tax avoidance/evasion fester, then cut taxes

1) Top income/inheritance tax rates have fallen

2) Corporate tax rates have fallen due to tax competition

3) Wealth and inheritance taxes easy to avoid or evade (and some have been repealed)

4) Many capital income flows to individuals treated preferentially (e.g. dual income tax systems)

Is this due to changes in elasticities or social objective?

Elasticities depend on the design of taxes (Slemrod)

Global Corporate Minimum Tax Agreement

Multinationals move 40-50% of (paper) profits to tax havens

Recent international agreement Oct 2021 (136 countries)

Each country will police its own multinationals by imposing a minimum tax of 15% on foreign profits country-by-country:

Apple pays 5% on its profits in Ireland, US charges extra 10%

$\Rightarrow$ Kills the pure tax haven model but three weaknesses:

a) 15% is low

b) Carveout for payroll+tangible capital deployed abroad $\Rightarrow$ Kills pure tax haven but not real competition

c) No large countries have yet enacted the proposal

Offshore Tax Evasion of Individuals

Rich individuals can evade taxes on wealth and capital income using offshore accounts in tax havens with bank secrecy

US passed FATCA in 2010: requires foreign banks to report accounts owned by US persons to IRS or face stiff penalties

$\Rightarrow$ Almost all banks complied (Panama papers leak risk)

$\Rightarrow$ Extended to over 100 countries in 2014: OECD **Common Reporting Standard**

$\Rightarrow$ Much harder to evade taxes through offshore accounts

Model: one large country (US) moves first and others join in

Revival of Progressive Wealth Taxation?

Wealth taxes abandoned in most EU countries because:

(a) incomplete tax base, (b) poor enforcement: offshore evasion or moving abroad was easy, (c) unpopular due to low exemption thresholds

All 3 issues can be resolved: (a) comprehensive tax base, (b) FATCA+expat or exit tax rules, (c) high exemption thresholds

Such effective wealth taxes proposed in the US policy debates

A few countries have passed wealth taxes on ultra-rich after covid crisis (Argentina, Bolivia) and many are considering