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Taxing the superrich

Challenges of a
fair tax system



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About the author

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Florian Scheuer is interested in the policy implications of rising inequality, with a focus on tax policy. In particular, he has worked on incorporating important features of real-world labor markets into the design of optimal taxes. These include economies with rent-seeking, superstar effects or an important entrepreneurial sector, frictional financial markets, as well as political constraints on tax policy and the resulting inequality.

His work has been published in the *American Economic Review*, the *Journal of Political Economy*, the *Quarterly Journal of Economics* and the *Review of Economic Studies*, among other journals. In 2017, he received an ERC starting grant for his research on “Inequality – Public Policy and Political Economy.” Before joining Zurich, he was on the faculty at Stanford, held visiting positions at Harvard and UC Berkeley and was a National Fellow at the Hoover Institution. He holds a PhD in Economics from MIT. He is Co-Editor of *Theoretical Economics* and Member of the Board of Editors of the *Review of Economic Studies*. He is also a Co-Director of the working group on Macro Public Finance at the NBER.

Management summary

Over the past decades, many developed countries have experienced considerable increases in income and wealth inequality, led by an extraordinary concentration among the very richest swath of households. This has focused policy attention on the superrich. Various political and economic arguments for at least partially offsetting this rise in inequality have been put forward. In particular, politicians have called for increasing the tax burden on rich households, both in the form of higher top rates for existing income taxes as well as new tax levies targeting the superrich. Most prominently, the idea of introducing an annual wealth tax has recently gained attention in the United States.

This Public Paper provides an overview of the tax situation the superrich currently face and evaluates various reform proposals. We emphasize that the incomes of the superrich are qualitatively different from others. Some are “superstars,” for whom small differences in talent are magnified into much larger earnings differences, while others work in winner-take-all markets, meaning that their effort to climb the ladder of success reduces the returns to others. Moreover, the discussion about tax rates must be accompanied by attention to the tax base, with a special focus on capital gains, which comprise a large fraction of the taxable income of the superrich. We also review the pros and cons of wealth taxes versus alternative policies that achieve similar objectives. While a dozen OECD countries levied wealth taxes in the recent past, only three retain them at present. Only Switzerland raises a similar fraction of revenue with its wealth tax as the recent U.S. proposals, therefore serving as a useful example.

Why do taxes on the superrich matter?

The recent focus on how the very rich are taxed is tied to widespread concern about the extent and growth of inequality. Indeed, the top 1% of households ranked by income in the U.S. earned about 12% of total income in the early 1980s, but this share has recently doubled to almost 25% (World Inequality Database). The concentration of wealth is even more extreme, with the top 1% ranked by net wealth holding roughly 40% of the United States' total wealth in recent years, as opposed to roughly 25% in the 1980s. Many other advanced countries have experienced similar trends, although typically less pronounced. Notably, Switzerland has seen a much less steep increase in inequality: The top 1% share of income has increased from about 8% in the 1980s to 12% more recently, and the top 1% wealth share from 33% to 40%.¹

Not surprisingly, the discussion about inequality and tax justice has intensified in many countries. Particular attention has been devoted to whether the very richest individuals in our society pay their “fair share” of taxes, or whether there are deficiencies in how our current tax system addresses the superrich. For example, the British historian Rutger Bregman's call for action at last year's World Economic Forum in Davos, “We've got to talk about taxes, taxes, taxes!”, went viral. Accordingly, policy makers have made various proposals to increase taxes on top earners and wealth holders, in some cases dramatically. In the United States, newly elected but immediately prominent Congresswoman Alexandria Ocasio-Cortez proposed adding a new 70% income tax bracket on income in excess of \$10 million in 2019. Two former presidential candidates, Senators Bernie Sanders and Elizabeth Warren, proposed that the

United States enact an annual wealth tax. Warren proposed a 2% rate on net worth in excess of \$50 million and a 6% rate above \$1 billion, while Sanders's proposal featured graduated rates starting at 1% on net worth above \$32 million for a married couple, rising to a marginal annual tax rate of 8% on net worth above \$10 billion (which would currently affect less than 50 persons). In the United Kingdom, the 2017 Labour Party manifesto proposed reintroducing a 50% top income tax rate, 5% higher than the current rate. France levied a top marginal income “supertax” rate of 75% on earnings over 1 million Euros from 2012 to 2014, but scrapped it and returned to a 45% top rate in 2015.

Designing the tax system in a way that captures the superrich adequately is important because the potential revenue effects are large. Indeed, it is often pointed out that those at the top of the distribution (such as the top 1%) already account for a disproportional share of total tax revenue. While this is true, such statistics are not a meaningful measure of the amount of redistribution a country's tax system achieves. The reason is that they conflate the inequality in pretax incomes with the progressivity of the tax code. To take an example, in a country with an extremely unequal pretax income distribution where the top 1% earn all of the income and everyone else earns nothing, the top 1% will also bear all of the tax burden no matter how progressive the tax system is (i.e., even under a flat or regressive tax schedule). It is therefore more informative to look at average tax rates. Accordingly, we will begin with shedding light on the average tax rate of the superrich and how it compares to those further down the distribution.

Who are the superrich?

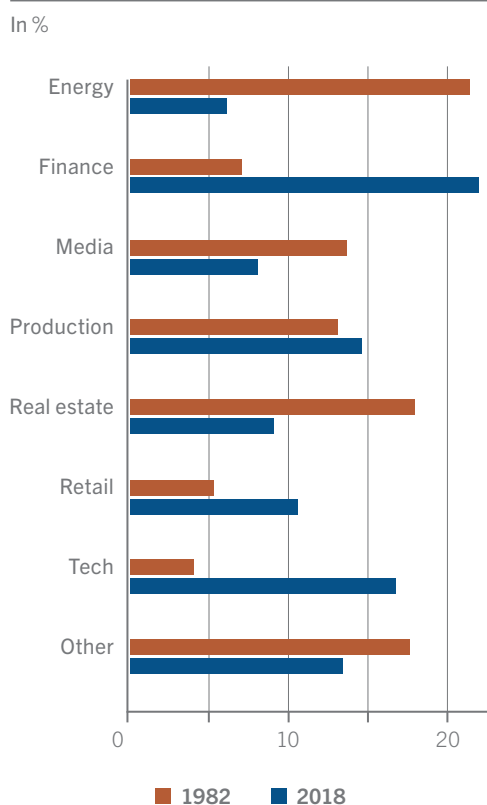
Data on very rich households often focus on the top 400 in the U.S., which comprise the top 0.0003% of households, but also address the top 0.01% to 1% of all households.² A conceptually more important definitional issue is whether to measure affluence with wealth or income. We begin with wealth.

The superrich by wealth

Because billionaires have been singled out in some of the latest tax proposals

in the U.S., it is worth studying them in more detail. The best-known data about billionaires is the annual Forbes 400 list of the wealthiest Americans, going back to 1982, which is based on public information supplemented by investigative reporting. The cutoff to make it into the Forbes 400 in 2018 was a net worth of \$2.1 billion, and the average wealth in this group was \$7.2 billion. The share of aggregate U.S. wealth owned by the Forbes 400 has increased from less than 1% in 1982 to more than 3% in 2018.

Fig. 1 Industry composition of the Forbes 400's wealth-generating businesses



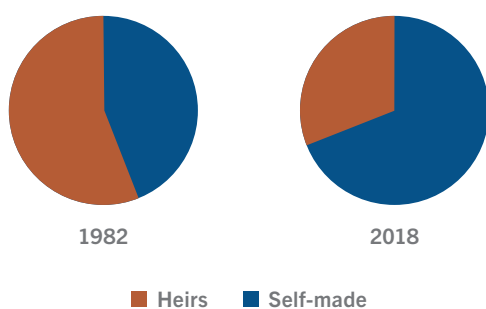
Source: Scheuer and Slemrod (2020a).

Figure 1 shows how the industry composition of the Forbes 400's wealth-generating businesses has changed between 1982 and 2018. Businesses in the financial sector have increased in representation from 7% to 22% and in the technology sector from 4% to 17%. This aligns with the most well-known names on the list, such as investor Warren Buffet (founder of Berkshire Hathaway and number 3 on the list) and tech founders Jeff Bezos (Amazon, number 1 on the list) and Bill Gates (founder of Microsoft and number 2 on the list). On the other hand, the representation of the energy sector fell from 22% to 6% and of the real estate sector from 17% to 9% during the same time frame. Nonetheless, even today, there is still a significant share of businesses in traditional sectors. This includes production and manufacturing, such as Charles Koch and the heirs of his late brother David Koch, owners of Koch Industries, and retail, such as the Walton family, founders of Walmart.

Another important distinction, particularly when it comes to the taxation of the superrich, is whether they are “self-made,” i.e., whether they accumulated their wealth themselves, or whether they

Fig. 2 Self-made vs. heirs in the Forbes 400

Composition of the Forbes 400 into first- versus second-generation businesses



Source: Scheuer and Slemrod (2020a).

inherited most of it. Figure 2 shows that the share of first-generation founders has increased significantly, from 44% in 1982 to 69% in 2018. The average age of those on the Forbes 400 list has decreased as well, which illustrates how, thanks to globalization and technology, they could expand their businesses vastly and extremely quickly, allowing them to build very large fortunes within their lifetimes. The Forbes 400 in 2018 were also well educated, 86% graduated from college, up from 76% in 1982.

The superrich by income

Our comments above only considered wealth. What about income? For tax years 1992 to 2014, the U.S. Internal Revenue Service (IRS) released aggregated information about the 400 individual tax returns with the highest gross incomes. The cutoff for inclusion into the “Fortunate 400” rose from \$24 million in 1992 to \$127 million in 2014. The share of total income the top 400 earned more than doubled, from 0.5% in 1992 to 1.3% in 2014, while their share of the total number of filed income tax returns fell slightly. Their share of the total amount of income taxes paid also increased, but by not quite as much, from 1% to 2%, reflecting in part the

fact that their average tax rate fell over this time from 26% to 23%. Notably, the average tax rate did not just fall during this period; its lowest point in the period was 17% in 2007. As the Public Paper will discuss below, the majority of the Fortunate 400’s income stems from capital gains, and capital gains taxation is crucial in determining their average tax rate. For example, their average tax rate jumped from 17% to 23% between 2012 and 2013, reflecting the fact that the top marginal tax rate on long-term capital gains rose from 15% to 20% between these two years.

Bakija, Cole, and Heim have studied the occupational composition of top income earners in the U.S., defined as the top 0.01%, from 1979 to 2005 using tax administrative data.³ They find that executives, managers, supervisors, and financial professionals accounted for approximately 60% of this group in 2005. Compared to 1979, the share of executives, managers, or supervisors decreased from roughly 48% to roughly 43%, while the share of financial professionals increased from 11% to 18%, and the increase in the share of income stemming from these professions accounts for 70% of the growth in the income share of the top 0.1%. Individuals in the top 0.1% saw their income grow at considerably higher rates than individuals in the same occupations within the 99th to 99.5th percentile range. We will turn below to the potential reasons for this fanning out at the very top.

The canonical definition of income is consumption plus the change in wealth. However, the measure of income considered so far has been based on a country’s definition of taxable income. The principal omissions are inheritances and unrealized capital gains, but also often exclude unreported (i.e., evaded) income, legitimately tax-exempt income, the implicit flow of services from durable goods (mainly owner-occupied housing), and the accrual of rights through insurance and pension

plans. Notably because of the importance of unrealized capital gains at the very top of the income distribution, realized income can be a poor measure of well-being, and taxable income data generally understates actual economic inequality.

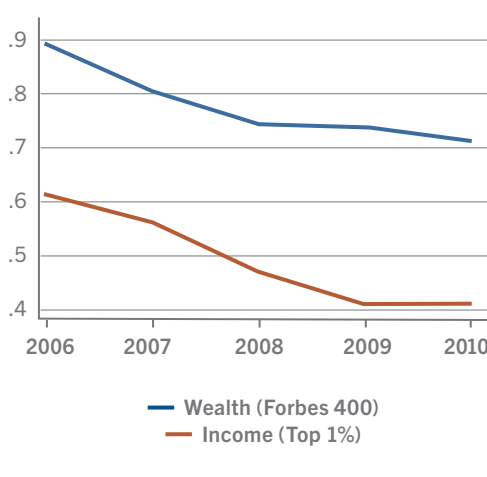
Economic mobility

So far, we have taken a one-shot static view of income inequality. In reality, individuals face a productivity profile over their lifetimes, as well as random shocks to their earnings, which produce “churn” in the cross-sectional income distribution from year to year. As to the taxation of top incomes, it is then crucial to determine how the composition of the superrich varies over time. Do top earners have consistently high incomes, or are many of them only temporarily at the top of the distribution in any given year? The answer to this question affects our view of who the superrich are and hence how they should be taxed.

The “Fortunate 400” data collected by the IRS provides some information on the persistence of top incomes. This data, which covers the years 1992 to 2014, provides information about the 400 individuals with the highest reported income in each year. Over the 23 years covered, 4,584 unique taxpayers made it onto the list, compared to the total of 9,200 slots available if there was absolutely no overlap across years. 138 taxpayers made the top 400 in 10 or more years, while the vast majority of 3,262 showed up in just one of the years. In interpreting this apparently low persistence, however, one must keep in mind the importance of realized capital gains in the gross income of the Fortunate 400: Realized gains show particularly high volatility that usually does not reflect variation in true annual economic income. For example, a founder of a startup company who sells her shares upon a successful exit will realize large capital gains in the year of the exit, but typically not in the previous or subsequent years. Thus, the numbers

Fig. 3 Top 1% income survival rates in the Forbes 400

Reoccurrence rate for the top 1% income earners in 2005 and those with wealth



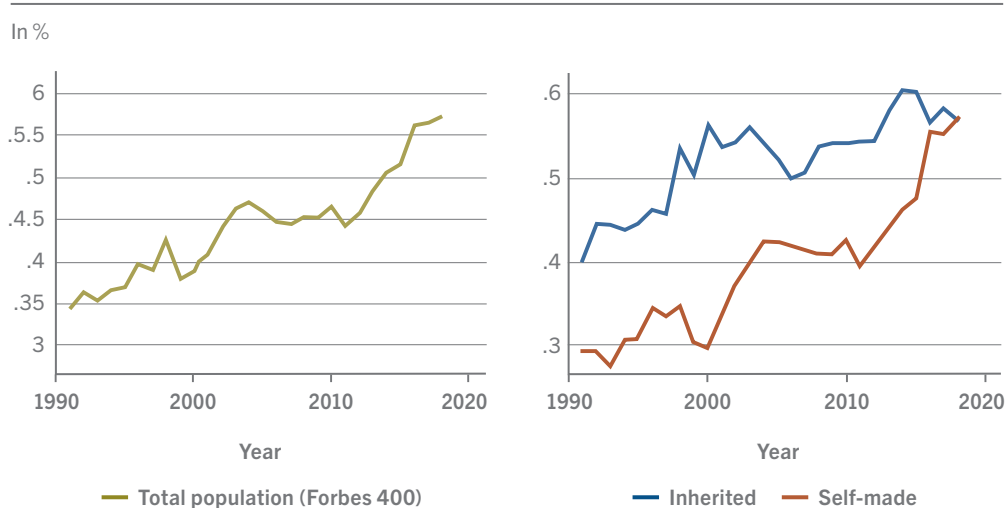
Source: Scheuer and Slemrod (2020a).

in large part tell us that there is a lot of churn year to year among those who realize large gains.

Considering larger groups of top earners, among those in the top 0.01% of the income distribution in 1996 (roughly 12,000 households), only 23% still showed up in this group 10 years later. However, over 80% of them remained within the top 1%, and only 6% dropped out of the top quintile in 2005. Figure 3 plots the one- to five-year persistence rates of those in the top 1% of the income distribution in 2005. For instance, 39% of individuals already exit the top percentile the following year.

Given the churn in annual incomes at the top, one might consider wealth as a better indicator of lifetime inequality. Using the Forbes 400 data on the wealthiest Americans, we compute the one- to five-year survival rates of those on this list in 2005, and compare them to the survival rates for income in Figure 3. This indeed reveals the much higher persistence of top wealth. For instance, of those who were among the Forbes 400 in 2005,

Fig. 4 Wealth persistence of the superrich



Notes: The left panel depicts the share of those in the Forbes 400 for 10 continuous years prior, from 1992–2018. Right panel shows the decomposition into those classified as self-made versus heirs.

Source: Scheuer and Slemrod (2020a).

89% percent were still listed in 2006, and 71% remained in 2010. In fact, the wealth persistence of the superrich has risen considerably over the last few decades. The left panel of Figure 4 shows the share of those in the Forbes 400 in each given year who were on the list in all 10 prior years. This share has risen from less than 35% in 1992 to almost 60% in 2018, even though the share of “self-made” business founders has increased during the same period. Indeed, while the persistence of inherited wealth has remained relatively stable, the overall trend is driven by the fact that even “self-made” wealth has become more and more persistent over time (right panel of Figure 4).

What tax burden do the superrich carry?

What is the current tax system and what burden does it place on those at the top of the distribution? The highlighted section on the following pages (p. 12–14) provides some relevant indicators on statutory taxes for developed (OECD) countries.

The effective tax burden on the superrich

Assessing the burden of taxes on the superrich by examining statutory rates gives an incomplete picture. First is the issue of shifting, or incidence. Taxes that are legally paid by the superrich may be shifted via tax-induced changes in pre-tax prices. For example, if taxes reduce the labor supply of high-skilled individuals, this could increase the wages that firms are willing to pay them, thus shifting part of the tax burden onto firms. The extent to which this happens depends on the nature of income. Below we discuss how such general equilibrium effects affect the optimal taxation of the superrich.

Second, the effective tax rate depends on how effective a country's enforcement system is in constraining tax evasion. Evasion distorts the measurement of both income and wealth – and taxes on these bases – especially when data is derived from tax returns. Evasion by the superrich is difficult to uncover through traditional means like random audits, as the auditor typically lacks the resources to trace the sophisticated means of evasion often involving layers of financial intermediaries. However, high-profile leaks from these intermediaries, such as the 2007 leak from HSBC Bank in Switzerland and the 2015 “Panama Papers” from the firm Mossack Fonseca, have

recently allowed researchers to gain insights into tax evasion by the richest. Alstadsæter, Johannesen, and Zucman use data from these leaks along with administrative data from Norway, Sweden, and Denmark to show that evasion rates rise across the income distribution, and conclude that the top 0.01% evade about 30% of the income and wealth taxes they owe.⁴ The authors link the account names from the HSBC leak with individual tax data and find that 95% of these foreign account holders did not report the existence of the account on their tax forms. They argue that this evidence is consistent with a fixed cost element to setting up evasion vehicles such as trusts and haven accounts, and that these costs are relatively small compared to the tax liability owed.

Capital gains and the plasticity of taxable income

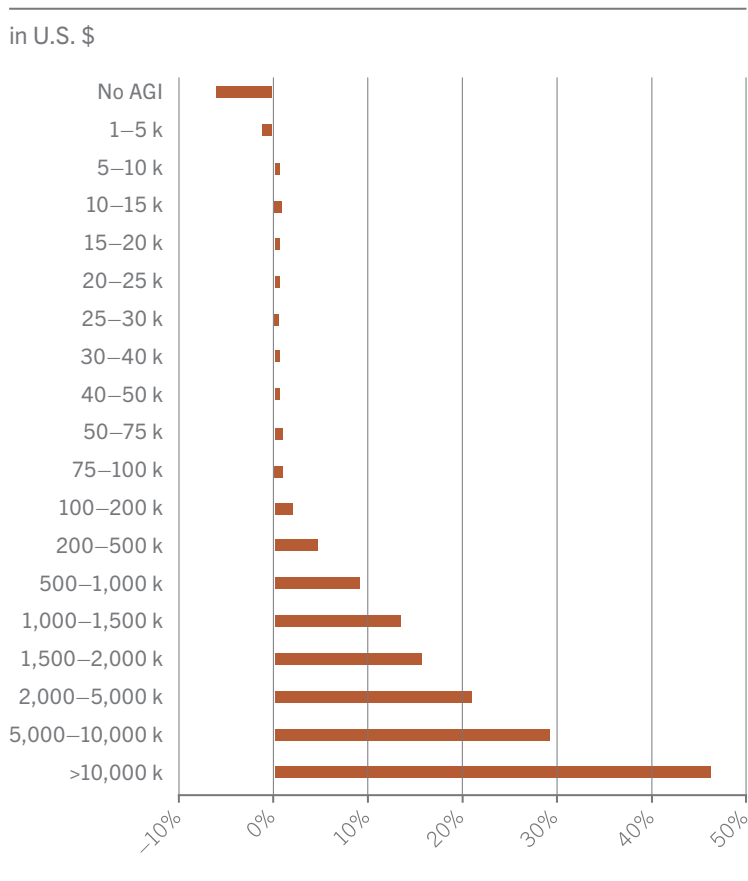
One key determinant of the optimal taxation of the superrich is the behavioral response of the tax base to changes in the tax rate. For the superrich, this response depends crucially on what Scheuer and Slemrod call the “plasticity” of the tax base, i.e., the ease with which higher-taxed income can be converted into lower-taxed income.² Plasticity is an issue when different kinds of income are subject to different effective tax rates. By far the most important aspect of plasticity, with implications both for understanding the effective tax burden on the superrich and for measuring the extent of their income and therefore income inequality, concerns capital gains. Most countries' tax systems treat capital gains favorably relative to ordinary labor income (Switzerland being an extreme case where most capital gains are untaxed).

Realized capital gains represent a very high fraction of the reported income of the superrich. For example, realized capital gains represented 60% of total gross income for the 400 highest-income Americans in tax year 2014. More generally, Figure 5 plots the distribution of net capital gains as a share of gross income across income groups for tax year 2016, which reveals their concentration at the very top: those earning more than \$10 million report net capital gains corresponding to 46% of their total income, whereas capital gains are a negligible fraction of income for those earning less than \$200 k.

Arguably, much of what shows up as capital gains of the superrich is in fact compensation for labor. An important example is founders' stock. Founders of startup firms and their employees often receive relatively modest wage salaries because startups are typically short on cash. Instead, most of the compensation takes the form of company shares. When the startup is successful and reaches an exit, either by being sold to a larger company or by going public in an IPO, these shares often appreciate in value. When the owner sells the shares, the resulting income is taxed as capital gains, even though, from an economic perspective, it represents compensation for the labor effort during the startup phase of the company.¹ Of the wealthiest Americans according to the Forbes 400 list, founders' stock was crucial for many of them.

If the plasticity of converting labor compensation into capital gains has changed over time, it has implications for interpreting tax-return-based measures of income inequality. While a successful inventor in 1959 might have worked for a big company, earned a nice raise, and increased income for his employer, the income might barely show up at all in 2020, unless the founder sold her shares after an IPO, at which time there might be taxable capital gains. The implications for measured wealth would be dif-

Fig. 5 Net capital gains as a share of adjusted gross income (AGI) across income groups



Source: Scheuer and Slemrod (2020a).

ferent as well, as the inventor would gradually accrue wealth and the shareholders would become wealthier in 1959, while the wealth would be much more concentrated in the founder in 2020.

Tax advantages of capital gains and tax progressivity

There are three tax advantages in receiving income in the form of capital gains rather than ordinary labor income:

1. Capital gains are taxed at a preferentially lower rate than other income. In the U.S., the top tax rate on long-term capital gains is 20%, much lower than the top marginal tax rate of 37% on ordinary income. In Switzerland, capital gains are not taxable at all.
2. They are taxed upon realization rather than accrual, which generates a so-called deferral (or interest) advantage. This is because capital gains only are realized, and hence taxes become due, when the asset is sold, which typically occurs much later than when the capital gains had actually accrued (for example as measured by the market value of the underlying asset).
3. Most importantly, capital gains are completely excused at death due to the “step-up” of tax basis for bequeathed assets that have appreciated in value. In other words, if the owner of, say, some stocks never sells them during her lifetime, her heirs will not need to pay taxes on the capital gains that had accrued up to the time of her death.ⁱⁱ Comparisons between capital gain realizations reported on income tax returns with historical stock market gains suggest that a large share of all capital gains on corporate stock were never taxed because the gains were not realized during the holder’s lifetime and the stock holdings were passed along at death.

The concentration of capital gains at the very top and their preferential tax treatment have led to concerns that the overall progressivity of the income tax is

effectively being eroded. These structural problems with the income tax are best illustrated by considering some extreme examples. The richest person in the world, Jeff Bezos, owns roughly 12% of Amazon stock. Accordingly, his economic income consists of about 12% of the profits of Amazon. How much tax does he pay on this income? First, Amazon pays corporate income tax on its profits. How much precisely is hard to pin down due to tax reporting strategies that involve reporting profits in tax havens. U.S. corporations pay an average corporate income tax of roughly 16% of their profits, which can be taken as an optimistic estimate in the case of Amazon. Since Amazon currently does not pay dividends and Bezos does not receive a wage salary, he would only pay personal income tax if he were to sell some of his Amazon shares. In this case, the proceeds would be taxed as capital gains at a preferential rate. In any case, it is clear that these taxes add up to a rather modest overall average tax rate.

Another example is Warren Buffett, currently number 3 on the Forbes 400 list. In 2015, Forbes reported his wealth to be \$62 billion. Even if we assume a modest rate of return of 5% on his wealth, we obtain a potential income flow of \$3 billion.^{iv} Buffett released his tax return for 2015, which reported a gross income of only \$11.6 million, mostly from the realization of capital gains. Hence, his income subject to taxation amounted to only a tiny fraction of his true economic income stream, and on top of that, it benefited from preferential tax treatment. Indeed, Buffett himself complained that his average tax rate was lower than that of his secretary, which he believed to be wrong. This gave rise to the “Buffett Rule” tax initiative under the Obama administration in 2011, which would have applied a minimum tax rate of 30% on individuals making more than one million dollars a year.

Statutory taxes on the superrich in OECD countries

Income tax

Figure 6 shows the top statutory personal income tax rate, defined according to OECD (2018) as the combined central and subcentral government marginal personal income tax rate on wages at the earnings threshold where the top statutory personal income tax rate first applies, taking the effects of tax credits, the deductibility of subcentral taxes in central government taxes, etc., into account. For 2018, this varied from 15% (Lithuania) to 57% (Sweden), with a median value of 46%. The threshold at which the top rate applies varies widely as a multiple of the average wage, from zero (in Hungary) where the rate schedule is flat, to 25 (in Mexico). For those with income far above the threshold, the average tax rate, i.e., tax liability divided by income, should in principle be well approximated by the top rate, but some caveats are discussed below.

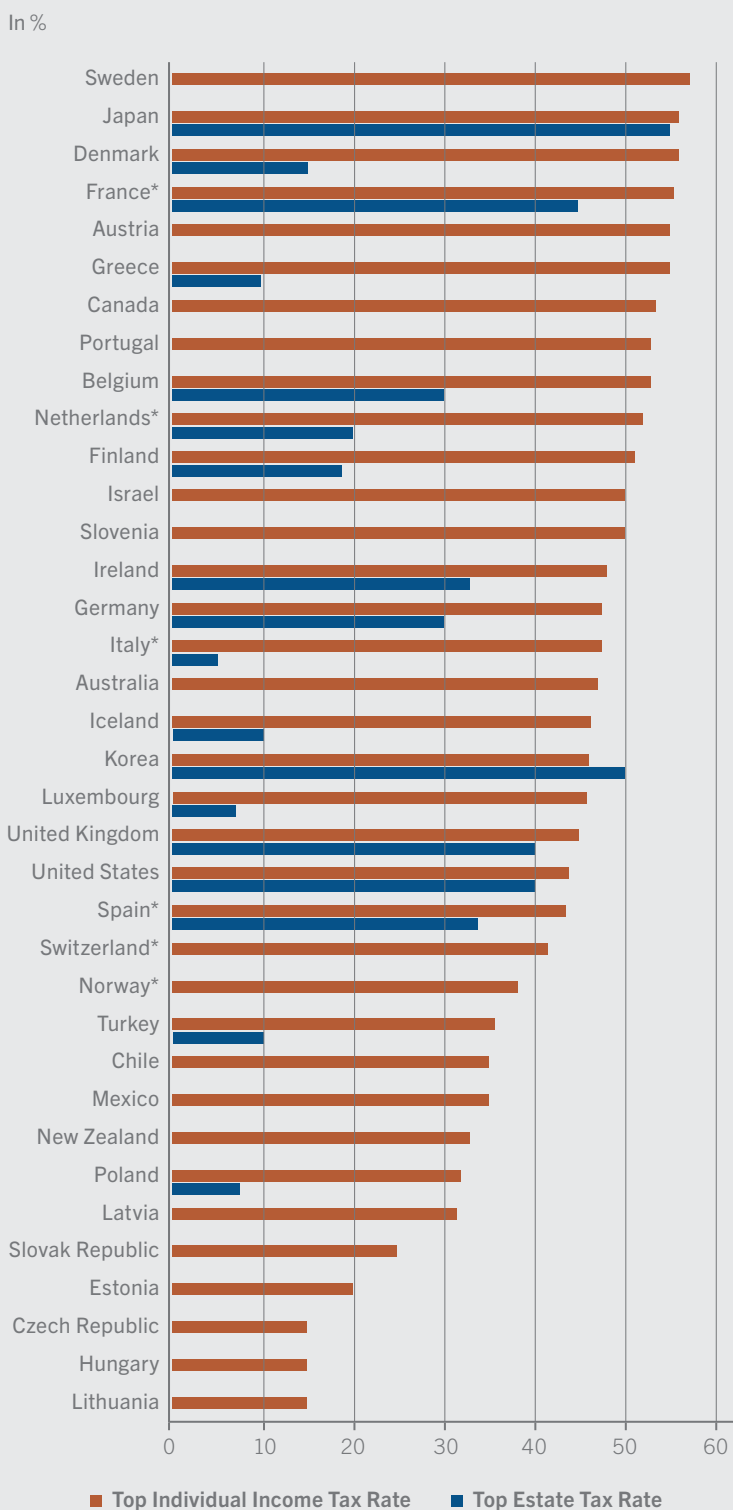
Capital gains tax

Five OECD countries levy no tax on shareholders based on capital gains (Switzerland being a prominent example). Of those that do, all tax is on realization rather than on accrual. Five more countries apply no tax after the end of a holding period test, while four others apply a more favorable rate afterwards. The tax rate varies widely, with the highest as of 2016 being Finland, at 34%. With a few exceptions, the accrued gains on assets in a decedent's estate escape income taxation entirely, because the heir can treat the basis for tax purposes as the value upon inheritance.

Wealth transfer taxes

Estate, Inheritance, and Gift Taxes. As of 2017, 26 of the 35 OECD countries levied some kind of tax on wealth transfers; inter vivos gifts are included in the base in a few countries, while a separate gift tax

Fig. 6 Maximum statutory tax rates in 2018



Notes: Countries with a wealth tax are indicated by a star (*).

Source: Scheuer and Slemrod (2020a).

Table 1 European wealth taxes

Country /Plan	Revenue as % of GDP	Years of enforcement	Top marginal rate – Most recent	– Ever	Exemption level – Single	– Married	# of marginal rates	Cap on liability?	Treatment of: Main residence	Life insurance	Pension	Business assets	Estate/inheritance/ gift tax?
	[1]	[2]	% [3]	% [4]	€ [5a]	€ [5b]	[6]	[7]	[8]	[9]	[10]	[11]	[12]
Switzerland	1.08	(1840–1970) to present	0.1–1.10	x	25,380–116'250	51,150–232,500	1–1,000	Y*	TP	T	E	TP	Y
Iceland	0.58	1096–2005, 2009–2013	2.00	2.00	473,248	630,997	2	N	T	E	E	TP	Y
Norway	0.45	1892 to present	0.85	1.10	157,833	315,666	1	N	TP	E	E	TP	N
France	0.22	1982–1986, 1989–2017	1.50	1.80	1,300,000	1,300,000	5	Y	TP	T	E	E	Y
Sweden	0.19	1947–1991, 1991–2007	1.50	4.00	166,214	221,619	1	Y	T	T	E	E	N
Spain	0.18	1977–2008, 2011–present	0–3.75	0–3.75	400,000–700,000	800,000–1,400,000	8	Y	TP	T	E	E	Y
Ireland	0.10	1975–1978	1.00	1.00	88,882	126,974	1	Y	E	T	E	TP	Y
Finland	0.08	1919–2006	0.80	4.00	250,000	500,000	1	Y	TP	E	E	T	Y
Denmark	0.06	1903–1997	0.70	2.20	320,657	641,314	1	Y	T	E	E	T	Y
Germany	0.02	1952–1997	1.00	x	61,355	122,710	1	N	T	T	E	TP	Y
Netherlands	0.02	1965–2001	0.70	0.80	90,756	113,445	1	Y	TP	E	E	TP	Y
Austria	0.01	1954–1994	1.00	x	None	None	1	N	T	T	T	T	Y
Luxembourg	0.00	1934–2006	0.50	x	None	None	1	N	T	T	E	TP	Y

[1] OECD Global Revenue Statistics Database, line 4210 (individual recurrent taxes on net wealth). For active countries, the value for 2018. For inactive countries, the value in the most recent active year with available data. For Ireland, McDonnell 2013, p. 24. [2] OECD 2018, p. 76, Table 4.1. France abolished its wealth tax in 2017 and replaced it with a tax based on real estate; in 1096 (not a typo) Icelanders began paying a 1% tax on wealth (in fact, a tithe based on a 10% tax applied to an assumed 10% return on assets); Sweden made a major change in 1991; Switzerland's cantons introduced the tax gradually, with full adoption by 1970. [3]–[4] OECD 2018, p. 88, Figure 4.2, and various historical sources. Rates differ across Swiss cantons. The Spanish central government top rate is 2.5%; some regions levy higher rates (e.g., Extremadura's top rate is 3.75%) while others levy lower rates (e.g., Madrid's 100% credit results in an effective rate of 0%). [5] OECD 2018, p. 81, Table 4.2. Taxpayers are taxed individually in Finland and Spain. Exemptions differ across Swiss cantons. The Spanish central government statutory individual exemption is € 700,000; some regions have lower exemptions, including Aragon at € 400,000 and Catalonia at € 500,000. [6] OECD 2018, pp. 87–88. The Swiss canton of Basel Country has a schedule with rates increasing for each CHF 1,000 of reported wealth, up to CHF 1 million. [7] OECD 2018, pp. 88–89.* In some cantons, but not all. [8]–[11] OECD 2018, p. 84, Table 4.3. T = fully taxed, E = full exemption, TP = tax preference, x = no information. [12] OECD 2018, p. 24, Table 1.1.

Notes: For countries without currently active wealth taxes, the table reports information as of the most recent active year. „x“ indicates that no or insufficient information was available.

Source: Scheuer and Slemrod (2020b).

regime exists in others. Most countries levy an inheritance tax where the liability lies with the recipient and the rate of tax depends on their relationship of the heir to the deceased. A prominent exception is the U.S., which levies an estate tax irrespective of the heirs' circumstances and relationship to the deceased (with the exception of spouses). The exemption levels and rates vary starkly. Most countries have a relatively low exemption along with a graduated rate structure, the U.S. again being the exception, having an exemption of \$11.4 million per individual in 2019 and a flat rate of 40%.

Annual net wealth tax

While twelve OECD countries levied an annual tax on net wealth in 1990, only four – France, Norway, Spain, and Switzerland – still imposed such a tax in 2018, with Switzerland raising more than three times as much revenue as a fraction of total revenues (3.9%) as any of the other three countries (OECD, 2018). France replaced its annual wealth tax with a tax only on immovable property in 2018. Italy levies an annual tax on financial assets. The Netherlands has a hybrid system with similarities to an annual wealth tax, imputing an asset-type-specific rate of return to assets and assessing a 30% tax on those imputed returns.ⁱⁱⁱ

Table 1 provides some summary statistics about the OECD countries' wealth taxes based on Scheuer and Slemrod.⁵ A few aspects are especially worth noting:

1. The top rates of both the Sanders and Warren proposals are far higher than any top rate of the OECD wealth taxes. The average top rate was about 1%, and the highest of all is that of the Spanish region Extremadura, at 3.75%. However, the Spanish system and certain Swiss cantons feature a cap on the sum of wealth and income taxes as a fraction of taxable income, which is a feature of neither the Sanders nor Warren proposals. Such a cap limits the liquidity problem of a

high ratio of tax liability to disposable income (and imposes a zero marginal tax on wealth for those at the cap).

2. Many of the OECD wealth taxes featured exemption or preferential treatment of some forms of assets, notably the main residence, life insurance proceeds, pension wealth, and business assets. The Warren and Sanders proposals have no such exemptions, and extend the base to certain assets that few countries in the OECD included, such as assets held in trusts, retirement assets, and assets held by minor children.
3. The exemption level of the other countries' wealth taxes are much lower than Sanders and Warren proposed, averaging just about €500,000 for married couples, far less than the Sanders and Warren exemption levels of \$32 million and \$50 million for married couples, respectively.

Of the dozen OECD countries that have had a wealth tax in the last three decades, only a quarter still do. Why did the other three-quarters abandon them? A 2018 OECD report refers to efficiency costs, risk of capital flight, failure to meet redistributive goals, and concerns about high administrative costs. In Germany, the Federal Constitutional Court deemed the wealth tax unconstitutional in 1995 on the grounds that the tax's discrimination of property and financial assets was an infringement against the fiscal principle of tax equality. While this could be fixed in principle, it has not yet been attempted. In Sweden, it was argued that the special treatment of business equity made the wealth tax regressive, taxing middle-class wealth (housing, financial assets) and exempting the wealthiest individuals' assets (large, closely held firms); moreover, the wealth tax was blamed for spurring tax avoidance and evasion, including capital flight to tax havens.⁶

What should a fair tax system look like?

We now turn to the normative question – how should the superrich be taxed?

The classic view

The canonical view posits that top earners are rich simply because they have a greater income-earning ability than most everyone else. To the degree that such an unequal distribution of abilities is outside of our control, it naturally gives rise to a redistributive motive. For example, behind the veil of ignorance, we could agree to “insure” against the realization of ability draws, determined ultimately by the birth lottery. This justifies tax policies that redistribute some share of top incomes away from the superrich and towards less fortunate, lower-ability earners.

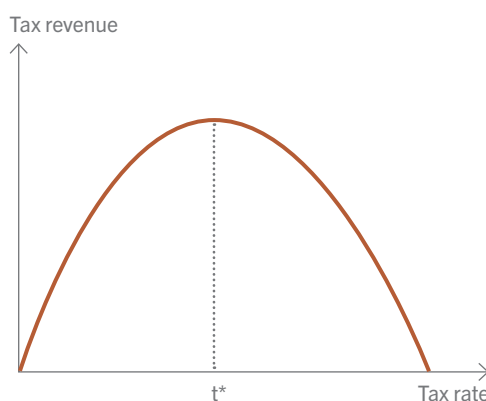
Of course, the inequality-reducing effects of redistributive taxation need to be balanced with the disincentive effects. Precisely how this tradeoff should be resolved depends crucially on one’s political attitudes towards inequality. Yet, it is hard to agree on this based on scientific principles (and, in fact, there are a variety of redistributive preferences in the population). Therefore, rather than trying to determine the optimal tax policy, it should be accepted that there will be different views on it, and instead the focus should lie on ruling out tax policies that everyone agrees to be undesirable.

This approach allows us to isolate the revenue effects of taxing the superrich.⁷ Figure 7 plots the relationship between the top marginal tax rate and the total revenue raised from top earners, which is commonly referred to as a “Laffer curve” after the economist Arthur Laffer. Of course, when the tax rate is low, tax

revenue is low as well. As we increase the tax, revenue increases but less than proportionally because the rising tax rate discourages economic activity, and hence the tax base shrinks. At some point, the additional revenues from the tax increase are outweighed by the reduction in the tax base, which occurs at the peak of the Laffer curve. Increasing taxes beyond this point is counterproductive: the same amount of revenue could be achieved by imposing a lower tax rate. This logic is familiar from the typical political rhetoric in favor of “self-financing” tax cuts.

It is clear that any tax rate to the right of the peak of the Laffer curve is inefficient in the sense that everyone could be made better off: taxing top earners at a lower rate both makes them better off and raises additional revenues, which can be used to benefit lower earners. On the other hand, tax rates to the left of the peak could be justified depending on society’s redistributive preferences. For example, if one mostly cared about helping the poorest

Fig. 7 The Laffer curve



members of society, one would go all the way up to tax rate t^* , which raises maximal revenue from the top income tax bracket and allows a transfer of these funds to the poor. However, someone with less extreme inequality aversion would prefer a lower top tax rate. In any case, the revenue-maximizing tax rate t^* is a useful benchmark, since it provides an upper bound to the taxation of the rich that should not be exceeded.

For this reason, it is of particular interest to figure out where precisely the peak of the Laffer curve lies. This crucially depends on two statistics:

1. The concentration of income in the top income tax bracket. The greater the total amount of income those affected by the top marginal tax rate earn, the more tax revenue can potentially be raised by increasing the tax rate they face.
2. The behavioral response of top earners to tax changes, which is often referred to as the elasticity of taxable income. It determines how much economic activity is discouraged – and hence how much the tax base shrinks – when the tax rate rises. If the elasticity is large, the tax base erodes quickly when we increase taxation, which implies that the revenue-maximizing tax rate is low.

A large body of research has estimated these two parameters. Even though there is some uncertainty around these estimates (see Scheuer and Slemrod for an overview)², middle-of-the-range studies suggest a revenue-maximizing top marginal tax rate of roughly 60% to 70%. This indicates that there is still considerable room in most countries to further increase top marginal tax rates, starting from current levels, without running into the downward-sloping part of the Laffer curve. Some recent proposals, however, such as Alexandria Ocasio-Cortez's envisioned 70% marginal tax rate on

incomes in excess of \$10 million, might exceed the upper bound according to these estimates.

Superstar effects

Many economists believe that “superstar effects” play an important role in the rise of top income inequality. The idea is that relatively small differences in ability or effort among workers are amplified by other factors, such as technology or globalization, leading to dramatic differences in pay. In a classic example, the advent of television enabled a small share of performers to capture a massive audience, leaving other artists in the dust.

A superstar story has also been used to explain the growing divergence in CEO compensation. In this narrative, larger, more productive firms snatch up more talented managers. Being surrounded by more efficient workers, having access to better resources, and commanding larger markets gives these managers an extra kick to their productivity – a complementarity. Hence, the matching of slightly more talented managers with larger firms accounts for the large difference in income between superstar CEOs and the rest of the pack. Because the distribution of firm sizes is extremely fat tailed – and has become increasingly so in the course of automation and globalization – top managers can make very large sums that eclipse any apparent differences in underlying skill or effort.

If superstars comprise a substantial portion of the superrich, how does this change the way they should be taxed? With earnings disproportionate to inherent skills, it may appear intuitive that superstar effects tilt the calculus balancing efficiency and equality, worsening inequality, and leading to higher optimal tax rates on the rich. However, the work of Scheuer and Werning shows that there is another effect.⁷ Because superstar effects lead to a steep relationship between effort and earnings, they increase the behavioral earnings response to any tax

change. Intuitively, a worker induced to provide greater effort by way of lower taxes anticipates being matched with a better job, with better pay, and this further amplifies the incentive for effort. This provides a force for lower taxes. Quantifying this effect, Scheuer and Werning find that taking superstar phenomena at the top of the distribution into account lowers the revenue-maximizing top marginal tax rate by more than 10 percentage points compared to the standard calibration.⁷

Taking superstars at the top of the distribution into account lowers the revenue-maximizing top marginal tax rate substantially.

Complementarities

Recently, much attention has been devoted to the impact of technological change on wage inequality, with a focus on the assignment of skilled and unskilled workers to different tasks and occupations (see e.g. UBS Public Paper No. 8).⁸ A key feature is that there is imperfect substitutability across sectors in the economy (routine versus abstract tasks, manufacturing versus services, entrepreneurs versus workers), which implies that relative wages react to the aggregate allocation of employment. Rothschild and Scheuer argue that these technological shifts imply a force for less progressive taxation relative to a world with fixed wages.⁹

To understand the basic intuition, suppose there are two occupations, entrepreneurs and workers, and individuals are free to select into either depending on their skills. There is an income tax (which does not condition on occupations) to

redistribute across individuals. If there are disproportionately more entrepreneurs at higher incomes, the government can exploit tax-induced general equilibrium effects to enhance redistribution from high- to low-income individuals: Lowering taxes on high earners will disproportionately spur effort among entrepreneurs. As a result, entrepreneurs will want to hire more workers, which will raise the worker's wages by stimulating labor demand. These "trickle down" effects (by which lower earners can benefit from tax cuts on higher earners) therefore also push for lower taxes at the very top.

Spillovers

In what we have discussed so far, the return to an individual equals his or her contribution to society. In this view, top incomes, no matter how high, reflect a correspondingly high social marginal product. Some recent policy discussion about rising inequality, however, has questioned whether top incomes result from extraordinary economic productivity. The financial crisis, for instance, exposed numerous examples of highly compensated individuals whose apparent contributions to aggregate output proved illusory. The "Occupy" movement lamented that some of the income growth for the top 1% may have been at the expense of the bottom 99%. Accordingly, the view that some top incomes reflect rent-seeking – i.e., the pursuit of personal enrichment by enlarging one's slice of the existing economic pie rather than by increasing the size of that pie – has inspired calls for a more steeply progressive tax code.

Rent-seeking is an example of a negative externality. Intuitively, the optimal policy is to levy a "corrective" tax equal to the marginal social damage. For example, if an activity provides a private return of one dollar but reduces others' income by 50 cents, the required correction is a tax of 50%. If some sectors or

professions are more prone to rent-seeking than others, sector-specific corrective surcharges could be used to discourage these activities while redirecting individuals to more productive behavior. For instance, higher taxes on financial-sector bonus payments have been proposed based on the idea that they result from contest-like tournaments or races with “winner-takes-all” compensation, such as high-speed trading. Others have argued that lawyers engage in rent-seeking activities akin to zero-sum games, or that CEOs can raise their pay artificially, for instance due to luck or by stacking a board of directors in their favor.

Research by Rothschild and Scheuer shows that it is not generally enough to know how much rent-seeking there is at any given income level in order to determine the optimal “corrective” adjustment to the income tax.¹⁰ Examining at whose expense overpaid individuals benefit is also critical. If CEO pay hikes are at the expense of productive workers further down the distribution, then raising top tax rates leads to an increase in more fruitful activities, and the optimal correction is even higher than the simple intuition above would suggest. But if top earners are making outside incomes by winning against others in the same line of work, raising taxes could backfire. One example is high-speed trading. If the most profitable traders faced higher taxes, that would discourage their activity – the intended effect. But this in turn would also make it easier for other, less efficient, traders who compete against them, with the unintended effect of potentially drawing even more traders into the fray.

Other forms of spillovers could be relevant as well. Some top earners might be paid below their marginal product, such as innovators who only appropriate a fraction of the value of their innovations. A frequently cited example is Steve Jobs, who provided valuable new products to the market and whose value to society

presumably exceeded his compensation. Yet another kind of externality, perhaps particularly relevant at the top, arises from “positional” concerns where individuals compare themselves to others and fail to internalize that increasing their income makes others less happy. For instance, if people care about earning more than their colleagues or neighbors rather than just their absolute amount of income, we may end up in a “rat race” where everyone works too much, which could be corrected through the tax system.^v

Should wealth be taxed?

It is clear that growing inequality in earnings affects the degree of wealth inequality down the road due to savings. This raises the question whether these trends not only shift the tradeoff for the optimal taxation of labor income, but also for the taxation of capital or wealth.

Taxing existing wealth

One argument in favor of taxes on wealth is that policy makers who consider a potential tax reform face a situation with preexisting wealth inequality. In other words, future labor incomes alone do not entirely determine future wealth. Instead, individuals already differ in the wealth they own, either because they have inherited it from previous generations or because they themselves have saved in the past. When deciding how to design tax policy going forward, one needs to recognize that this initial wealth inequality, which must be taken as given from today's perspective, will partially shape future wealth inequality.

In principle, preexisting wealth inequality could be redistributed in a lump-sum fashion through a one-time, unanticipated wealth tax. Indeed, various countries have historically used one-time wealth taxes to deal with revenue requirements, such as wartime spending shocks. In 1999, Donald Trump, then a candidate for the Reform Party presidential nomination, proposed a 14.25% one-time "net worth tax" on individuals and trusts worth more than \$10 million in order to eliminate U.S. national debt in one swoop. More recently, calls have been made for a time-limited, progressive wealth levy to stem the fiscal burden from the coronavirus pandemic.

From an optimal tax perspective, these policies are attractive because they avoid behavioral distortions by only touching wealth that has already accrued. Nevertheless, this appealing feature critically hinges on policy makers' ability to implement them on short notice and on their commitment not to make them permanent or reintroduce them when similar times come about in the future. In the past, originally one-off war taxes have often turned into long-lasting tax policies.

A tax on wealth accrual, on top of a progressive labor income tax, is in general optimal – even in the medium to long run.

The existing wealth taxes, such as the Swiss example, and the recent U.S. proposals are permanent policies, however. Since individuals anticipate that their future savings will be subject to the tax, this will of course distort their savings incentives. Nonetheless, since preexisting wealth makes up a significant portion of future wealth, the work of Scheuer and Slemrod shows that a tax on wealth accrual, on top of a progressive labor income tax, is in general optimal even in the medium to long run.⁴

Wealth versus capital income taxes

The discussion above does not define the appropriate tax instruments for taxing capital accumulation. Most countries have both progressive income taxes, which already tax the return on savings, as well as inheritance and gift taxes, which tax the transfer of wealth across generations. Indeed, there is a close connection between wealth taxes and taxes on capital income. For example, assume that all wealth earns an annual return of 4%; then levying a tax rate of 25% on capital income is equivalent to imposing a tax rate of 1% directly on the wealth each year. Conversely, a 2% wealth tax is equivalent to a 50% capital income tax and a 4% wealth tax would correspond to a 100% tax on capital income. Given the existence of capital income taxes, what might justify levying a wealth tax instead, or in addition?

One such argument, which goes back to Nobel Laureate Maurice Allais, is based on the observation that different wealth holders achieve different rates of return on their investments.¹¹ Some might be innovative entrepreneurs with promising business ideas, others just hold on to their wealth without investing it profitably. In this case, the capital-income-tax equivalent of a given wealth tax rate is also heterogeneous: the higher is the return, the lower is the equivalent capital income tax, so that more productive entrepreneurs face a lower capital-income-tax equivalent. As a result, a wealth tax imposes a higher burden on “idle,” low-return wealth and therefore encourages the reallocation of capital from unproductive to productive entrepreneurs.

There is, however, an opposing effect. If heterogeneous returns reflect heterogeneous windfall gains, rents, or excess profits (e.g. due to market power or inside information), rather than actual productivity differences, then taxing

those away has well-known efficiency benefits. However, a wealth tax gets this exactly reversed – it taxes the normal rate of return and leaves the excess returns untouched. For example, if all investors have a real rate of return of 2%, but some earn additional excess profits on their investments, then a 2% wealth tax would not target any of those rents, whereas a capital income tax would. This is because a wealth tax is equivalent to a unit tax on the rate of return rather than an ad valorem tax. Moreover, as we have argued above, much of what shows up as return to capital on the tax returns of the superrich (e.g. in the form of realized capital gains) is likely compensation to labor. A wealth tax again only taxes some normal return, while a capital income tax hits the full extent of such shifted labor compensation.

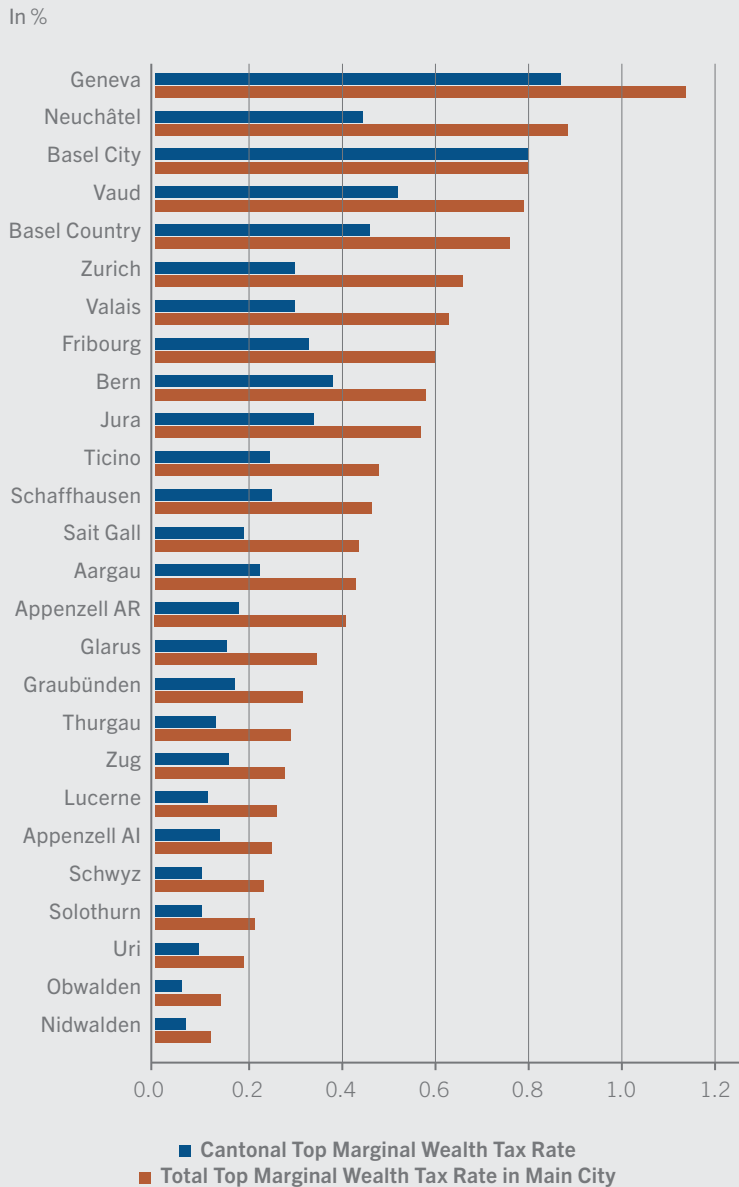
The Swiss wealth tax

Of the three European countries that still levy a wealth tax, Switzerland is the only one that raises a nonnegligible share of overall tax revenue with it. Total revenue from the Swiss wealth tax amounted to 1.1% of GDP in 2018, which is in a similar ballpark as the revenues projected for the recent U.S. proposals. Hence, the Swiss example is of particular interest for the wealth tax debate in the United States.

The wealth tax in Switzerland has a long history and in fact predates the modern income tax. The Swiss tax system is generally structured in three layers: the federal, cantonal, and municipal level. There is no federal wealth tax, but all cantons must levy a comprehensive wealth tax. Apart from that, cantons have significant freedom in designing wealth taxation. Nine cantons impose flat rates (above some exemption level) and the other 17 feature progressive schedules. Each municipality then chooses a multiplier that is applied proportionally to the cantonal tax rate schedule. Hence, an individual's overall tax liability depends on both the canton and municipality of residence. Unlike the recent proposals in the U.S., which all involve a federal wealth tax, this highly decentralized system induces local tax competition.

In Figures 8 and 9, we collected the top marginal tax rates as well as the tax-exempted wealth amount (for married couples) for all Swiss cantons from the cantonal tax laws in 2018.^{vi} The (combined cantonal and municipal) marginal wealth tax rates in the top bracket ranged between 0.1% (canton of Nidwalden) and 1.1% (canton of Geneva). In 16 of the 26 canton capitals, the annual top wealth tax rate was below 0.5%. There is also some variation in the tax-exempted amounts, although they are generally relatively low, ranging from CHF 50,000 in the canton of Obwalden to CHF 250,000 in the canton of Schwyz. Hence, even though it raises

Fig. 8 Top marginal wealth tax rates in the Swiss cantons



Source: Own research based on Swiss cantonal tax laws.

similar overall revenue as some U.S. proposals, the Swiss wealth tax is much less progressive and targeted at a larger share of the population.

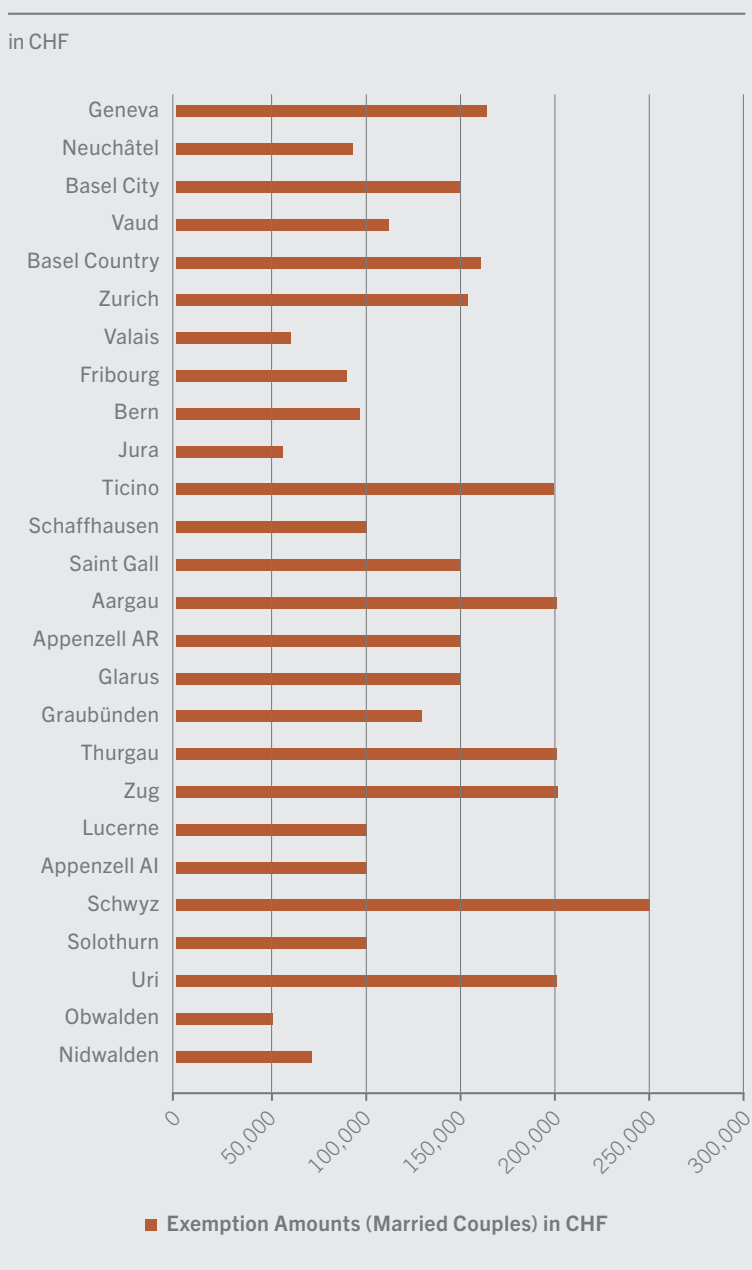
The base of the Swiss wealth tax is broad: in principle, all assets, including those held abroad, are taxable. Only foreign real

estate, usual household assets, and accrued pension wealth are exempt. The tax liability is based on net wealth, so taxpayers can deduct their obligations (such as mortgages or other debt). The annual reporting requirements for assets and liabilities allow the cantonal tax authorities to track the year-to-year evolution of wealth and cross-check it against reported income (the so-called wealth development test), so the wealth tax serves a supporting role for income tax enforcement.

There are several particularities of the Swiss tax system that limit the degree to which its experience with a wealth tax can be generalized to other countries:

1. Capital gains on movable assets (e.g. shares) are tax-exempt in Switzerland unless the owner professionally trades with securities. This is not the case in many other countries. In particular, the Warren and Sanders proposals in the U.S. involve introducing a wealth tax on top of the existing taxation of capital gains, and reforming the latter towards a less preferential treatment.
2. Almost all Swiss cantons have gradually abolished taxes on gifts and inheritances from parents to children, and there is no federal tax on bequests.
3. Due to the institution of bank secrecy within Switzerland, third party reporting of financial assets is precluded, which limits tax enforcement. Moreover, the valuation of privately held business assets is subject to considerable discretion on the part of cantonal tax authorities, which may contribute to an equilibrium where the wealthy are treated rather leniently.

Fig. 9 Maximum wealth amounts before any wealth tax liability is generated for married couples in the Swiss cantons



Source: Own research based on Swiss cantonal tax laws.

In sum, there is a defect in the income tax with regard to capital gains and bequests. The wealth tax therefore serves as a backstop to at least partly substitute for these instruments, which are commonly used in other countries but lacking in Switzerland.^{vii}

So far, the Swiss case is the only modern example for a wealth tax in an OECD country that has been able to generate sizeable and stable revenues in the long run. It enjoys broad support, as evidenced by the fact that it keeps being reaffirmed by citizens in Switzerland's direct democracy, where most tax decisions must be put directly to voters. However, its design and the role it plays in the overall tax system are quite different from current proposals in the United States. In particular, it is not geared towards a major redistribution of wealth, and indeed wealth concentration in Switzerland remains high in international comparison.

Policy implications

Political economy

The recent extent and growth of inequality has produced fears that it may lead to political instability. In a democracy, for example, a course of tax policy must regularly stand the test of elections. This raises the question whether it is politically sustainable, in the sense that it must maintain the support of a majority of citizens over time. Scheuer and Wolitzky show that this requires taxing the wealth accrual of the rich, while subsidizing that of the middle class.¹² The reason is that there is always a temptation in the future to reform whatever policy had been originally announced to try to attain a greater equalization of wealth because wealth accumulation will have been sunk at this time. Policy makers therefore realize that letting wealth concentration explode will lead to an unstable situation in the future, where a majority of voters will prefer a progressive reform. Anticipating this, individuals would save and invest very little in the first place, leading eventually to a poor outcome for everyone. Hence, from an ex ante perspective, it is better to design tax policy in such a way that it will defeat any future reform threat in terms of popular support. This is achieved by reducing wealth inequality through a tax on the savings of the rich, and by creating a middle class that accumulates just enough wealth to become unfavorable to more extreme redistribution in the future.

From this perspective, the role of the wealth tax is to make the system more stable, with limited inequality, so that it can resist the threat of political upheaval looming in the background. These threats were important drivers of tax and welfare state policies in 19th and 20th

century Europe, when the socialist movement gained momentum, and they are palpable today in many South American countries (Venezuela being an example that was not resilient, with disastrous consequences).

Another fundamental observation in political economy is that wealth can buy political influence. The concern is that, even in a “one-man, one-vote” democracy, billionaires can affect politics more than others through campaign contributions, ownership of media outlets, or funding lobbying activities. Indeed, there is evidence that political decisions are often more sensitive to the preferences of the rich than to those of the median voter.¹³ Accordingly, proponents of a progressive wealth tax have argued that reducing the wealth of the superrich is a desirable objective in itself, beyond the revenue it could raise. In this vein, Bernie Sanders famously said “I don’t think billionaires should exist.”

Even if concerns about an extreme concentration of wealth and political power are warranted, it is not clear how a wealth tax would help fix the problem. Other instruments may be better targeted at ensuring a more equal political representation, such as regulating campaign contributions and Super PACs. Some European countries with similar degrees of inequality offer examples of democracies where money plays a smaller role in politics than in the United States. One particular concern with the wealth tax is that it might encourage political donations (as they reduce tax liability) and thereby further stimulate political engagement of wealthy individuals.

Policy alternatives

Several alternatives to a wealth tax have been proposed to achieve its primary goal of increasing the progressivity of the U.S. tax system. As discussed above (page 11), the current system exhibits

structural deficiencies in the treatment of capital gains. Many have therefore proposed fixing these defects directly.

Indeed, Joe Biden has released plans to tax capital gains and dividends at the same rate as ordinary income for taxpayers with incomes exceeding \$1 million and to tax unrealized capital gains at death. His plan would also increase income tax rates for taxpayers with incomes over \$400,000 from 37% to 39.6%. Hence, the top marginal tax rate for capital gains would increase from 20% to 39.6%. However, his plan does not include a wealth tax.

While Biden’s plan would eliminate two of the preferential provisions for capital gains, it would retain the current system of taxation based on realization rather than accrual and thereby preserve the within-a-lifetime tax deferral advantage. Moreover, a realization-based treatment does not fix the problem of very low tax burdens for superrich individuals who neither receive much ordinary nor dividend income nor sell many shares of the businesses they own. In view of this, calls for the taxation of accrued capital gains have been made. An accrual-based capital gains tax is straightforward to implement for publicly traded assets because one can rely on market prices and third-party-reported transactions. For illiquid assets, however, such as privately held businesses, which are a significant source of returns for rich households, it runs into similar problems as a wealth tax because these assets are difficult to value objectively. Moreover, it might force entrepreneurs to continually reduce their share in a company whose valuation increases over time in order to pay the tax liability, another feature it shares with a wealth tax. Even if monetary incentives are not the primary motivation for these entrepreneurs, who are instead mostly interested in being able to realize their ideas, such a dilution of control rights could have discouraging effects early on, for example, when young individuals

decide whether to become entrepreneurs in the first place.

A potential solution to these problems is a retrospective accrual tax. Under such a scheme, the tax is assessed upon realization, but the statutory tax rate rises as the holding period lengthens, effectively charging interest on past gains when realization occurs. This eliminates the need to value assets except when sold while minimizing liquidity problems and the incentive to defer such realization. The table below summarizes the advantages and disadvantages of wealth taxes versus these different forms of capital gains taxation.

Overview of the pros and cons of wealth versus capital gains taxes

	Wealth tax	Capital gains tax		
		Accrual-based	Realization-based	Retrospective
I Allocating capital efficiently across investors with different rates of return	+	-	-	-
II Capturing excess returns and shifted labor income	-	+	+	+
III Difficulty of valuing illiquid assets	-	-	+	+
IV Eliminating deferral advantage	+	+	-	+

Notes:

- I A wealth tax encourages the reallocation of capital from unproductive to productive investors relative to a capital gains tax.
- II A wealth tax only taxes the normal rate of return on investments whereas a capital gains tax is also able to target excess returns.
- III A wealth tax and an accrual-based capital gains tax require the valuation of untraded assets whereas a realization-based or retrospective capital gains tax only relies on market transactions.
- IV A realization-based capital gains tax induces deferral incentives by providing an interest advantage since tax payments are only due when gains are realized. A wealth tax as well as accrual-based and retrospective capital gains taxes remove this advantage.

Conclusion

Concerns about inequality and its consequences have led to widely discussed proposals for increasing the tax burden on the superrich. Apart from calls for higher top marginal income taxes, two leading presidential candidates of the Democratic Party in the U.S. have proposed a new, highly progressive annual wealth tax. As their candidacies faltered, so did the attention to their proposals, although the coronavirus pandemic has revived calls for a one-time wealth tax to help fund the massive fiscal interventions it has engendered.

Whether these ideas constitute good policy depends on a number of factors, such as the effects of income and wealth concentration on the desired functioning of the political system and the appropriate weight to put on the well-being of the superrich versus other citizens. This Public Paper concentrates on the critical factors in designing the taxation of the superrich that are right in the wheelhouse of modern research on taxation. It provides upper bounds to the optimal rate of tax depending on the elasticity of behavioral responses to tax changes as well as the sources of the riches of the superrich – are they superstars, rent seekers, or job creators?

We emphasize that various tax bases might be used to tax the superrich and that their elasticities depend on the non-rate aspects of a tax system. Notably, the current tax system exhibits deficiencies when it comes to the treatment of capital gains. Whether fixing them should involve a wealth tax hinges on the costs of implementing it and on the attractiveness of alternative policies, such as reforms that address capital gains taxation directly. We also review

the experience of other OECD countries that have levied a wealth tax in the recent past, although now only three retain them. The Swiss example is particularly useful, but it involves relatively low rates along with a low level of wealth exempted, and it also features particular enforcement details such as the extent of third-party reporting of wealth.

In sum, there are effective tools for restoring tax progressivity where it has been eroding and for at least stabilizing the increase in inequality many countries have experienced at the top. A growing share of society cares deeply about these issues, and a precise understanding of both the roots of inequality and the effects of tax policy will help to inject some objectivity into the ongoing debate about taxing the superrich.

Notes

- i. Other examples of capital gains that are likely to be relabeled labor income are compensation in the form of stock options and the fees charged for the management of investment portfolios.
- ii. At the same time, the income that gives rise to the appreciation of some capital assets, such as corporate stock, is subject to taxation at the corporate level.
- iii. Several non-OECD countries have had wealth taxes, including Argentina, Bangladesh (more recently a net worth-triggered income tax surcharge or net wealth tax, whichever is higher), Colombia, India (repealed in 2015), Indonesia (abolished in 1985), Pakistan (removed in 2003 and reinstated in 2013), and Sri Lanka (1959–1993).
- iv. The average real growth rate of billionaire wealth has been 7% to 8% over the last decades.
- v. In the case of behavioral distortions or “internalities,” a paternalistic government could use “corrective” income taxes on similar grounds. For instance, top earners may be disproportionately plagued by workaholism.
- vi. The municipal multipliers in the main city of each canton are obtained from “Vermögenssteuer natürlicher Personen,” Dokumentation und Information, Eidgenössische Steuerverwaltung (2018).
- vii. As for immovable property, there is a special capital gains tax for real estate at the cantonal level. Moreover, about half of all municipalities also levy a property tax on real estate (with rates up to 0.3%), based on the gross value of the property. Finally, an estimate of the rental value of owner-occupied housing must be reported as taxable income for income tax purposes. On the other hand, the valuation rules used by the cantonal tax authorities to assess real estate property imply that it is typically valued below market for tax purposes, and this latter advantage often outweighs the double taxation.

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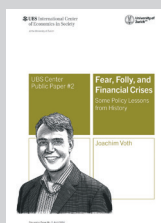
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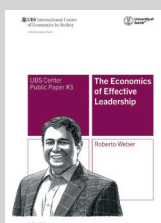
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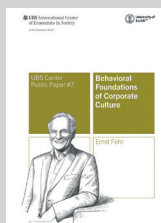
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