A CONTROVERSY SURROUNDING THE ESTIMATE OF REVENUE FROM THE PROPOSED U.S. WEALTH TAX

I INTRODUCING

Legislative proposals, which are submitted to public hearings as well as further legislative procedure, must include estimated financial data on budget revenue. In most countries, such a procedure is also regulated by law. Sometimes legislative acts have no impact on the budget, but often this impact is very important, whether it is increased or reduced budget tax revenue.

The assessment of the financial impact of a particular law is not a slight task. Namely, although it is only an assessment, that assessment must be as accurate as possible for the legislative authority to have access to the information that a particular law actually represents financially for the budget and the citizens.

When estimating the financial effect of a particular law, different methods are used, the most acceptable for this law, available and historical data, mathematical and statistical formulas and algorithms, trends etc.

And in the case of the US wealth tax law, the proponents of the law have made financial estimates of the effect of the law on budget revenue. These estimates caused various polemics of experts and the academic community.

II THE MAIN FIGURES OF THE LAW PROPOSAL[i]

United States Senator Elizabeth Warren (D-Mass.) January 24, 2019 unveiled the Ultra-Millionaire Tax, a bold proposal to tax the wealth of the richest 0.1% of Americans. The legislation, which applies only to households with a net worth of $50 million or more, is estimated by leading economists to raise $2.75 trillion in tax revenue over a ten-year period.

For decades, a small group of families has raked in a massive amount of the wealth American workers have produced, while America's middle class has been hollowed out. The result is an extreme concentration of wealth not seen in any other leading economy. According to an analysis from economists Emmanuel Saez and Gabriel Zucman from the University of California-Berkeley, the richest top 0.1% has seen its share of American wealth nearly triple from 7% to 20% between the late 1970s and 2016, while the bottom 90% has seen

its share of wealth decline from 35% to 25% in that same period. Put another way, the richest 130,000 families in America now hold nearly as much wealth as the bottom 117 million families combined.

Households would pay an annual 2% tax on every dollar of net worth above $50 million and a 3% tax on every dollar of net worth above $1 billion. Because wealth is so concentrated, Saez and Zucman project that this small tax on roughly 75,000 households will bring in $2.75 trillion in revenue over a ten-year period.

The Ultra-Millionaire Tax would impose:

- Zero additional tax on any household with a net worth of less than $50 million (99.9% of American households)
- 2% annual tax on household net worth between $50 million and $1 billion
- 1% annual Billionaire Surtax (3% tax overall) on household net worth above $1 billion
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The Ultra-Millionaire Tax also includes strong anti-evasion measures, including but not limited to:

- a significant increase in the IRS enforcement budget;
- a minimum audit rate for taxpayers subject to the Ultra-Millionaire Tax;
- a 40% "exit tax" on the net worth above $50 million of any U.S. citizen who renounces their citizenship; and
- systematic third-party reporting that builds on existing tax information exchange agreements adopted after the Foreign Account Tax Compliance Act.

III THE METHODOLOGY OF ASSESTMENT SAEZ AND ZUCMAN[ii]

Details on the estimation

Data sources: There are two main sources on the wealth of all American households: the Survey of Consumer Finances (SCF) from the Federal Reserve Board and the Distributional National Accounts (DINA) recently created by Piketty, Saez, and Zucman, which estimates wealth by capitalizing investment income from income tax returns. The latest year available for each source is 2016. Both sources can be used to estimate the tax revenue of the 2% wealth tax above $50 million. For the billionaire surtax, the best source is the Forbes

400 list of the richest 400 Americans. The latest year available is 2018. None of these sources provides perfect estimates but reassuringly, the SCF and DINA provide close estimates of the tax base above $50 million.

Methodology:

„1) We age the 2016 SCF and DINA microfiles to 2019 by inflating the number of households and wealth uniformly to match the aggregate projections for population and total household wealth from the Federal Reserve Board. We also add the Forbes 400 to the SCF data. The total household net worth projection is $94 trillion for 2019 (the SCF records a total household net worth of $87 trillion in 2016).

2) Tax avoidance/evasion: recent research shows that the extent of wealth tax evasion/avoidance depends crucially on loopholes and enforcement. The proposed wealth tax has a comprehensive base with no loopholes and is well enforced through a combination of systematic third party reporting and audits. Therefore, the avoidance/evasion response is likely to be small. To be on the conservative side, we assume that households subject to the wealth tax are able to reduce their reported net worth by 15% through a combination of tax evasion and tax avoidance. This is a large response in light of existing estimates.

3) In 2019, there would be around 75,000 households liable to the wealth tax (72,000 households according to the SCF data and 78,000 tax filers according to the DINA data). In both cases, this would be less than .1% of the 130 million US households in 2019. The tax base above $50 million would be $8.2 trillion based on the SCF data and $10.5 trillion based on the DINA data. Hence, the two data sources provide fairly close estimates, which we average as $9.3 trillion, i.e. approximately 10% of total household net worth of $94 trillion population-wide. A two percent tax on this base would raise $187 billion in 2019.

4) For the billionaire surtax, the Forbes 400 reports that in 2018 the top 400 richest Americans had an average net worth of $7.2 billion and that the 400th wealthiest had $2.1 billion. Given the recent stock price declines, we assume that the wealth of the Forbes 400 in 2019 will be the same as in 2018. We also assume that their reported wealth for tax purposes would be 85% of the Forbes estimate due to avoidance and evasion. Hence the top 400 wealth taxpayers would report at least $1.8 billion (=2.1.85) and have an average reported wealth of $6.1 billion (=7.2*.85). Hence, the Forbes 400 taxable base would be 400*(6.1-1)=$2040 billion or approximately $2 trillion. Using a standard Pareto interpolation technique, we estimate that the billionaire tax base between $1*

billion and $1.8 billion (below the Forbes 400) would add 25% to the Forbes 400 tax base and would add about 500 families. Therefore, the billionaire surtax base is estimated at $2.5 trillion and hence the billionaire surtax would raise $25 billion in 2019 from about 900 billionaire families.

5) The combination of the 2% tax above $50 million and the billionaire surtax would raise $187 + $25 = $212 billion in 2019.

6) To project tax revenues over a 10-year horizon, we assume that nominal taxable wealth would grow at the same pace as the economy, at 5.5% per year as in standard projections of the Congressional Budget Office or the Joint Committee on Taxation. This growth is decomposed into 2.5% price inflation, 1% population growth, and 2% of real growth per capita. This implies that tax revenue over the 10 years 2019-2028 is 13 times the revenue raised in 2019. This uniform growth assumption is conservative as the wealth of the rich has grown substantially faster than average in recent decades. The estimates by Saez and Zucman show that, from 1980 to 2016, real wealth of the top 0.1% has grown at 5.3% per year on average, which is 2.8 points above the average real wealth growth of 2.5% per year. Average real wealth of the Forbes 400 has grown even faster at 7% per year, 4.5 points above the average. The historical gap in growth rates of top wealth vs. average wealth is larger than the proposed wealth tax. Therefore, even with the wealth tax, it is most likely that top wealth would continue to grow at least as fast as the average.

*7) This 10-year projection implies that revenue raised by the progressive wealth tax would be 13*212=$2756 billion, rounded to$2.75 trillion. Out of these $2.75 trillion, the billionaire surtax would raise $25*13=$325 billion, rounded to $0.3 trillion*

8) It is important to emphasize that our computations assume that the wealth tax base is comprehensive with no major asset classes exempt from wealth taxation. Introducing exemptions for specific asset classes would reduce the revenue estimates both mechanically and dynamically as wealthy individuals would shift their wealth into tax-exempt assets. Because your proposal does not include any large exemptions, we do not believe our revenue estimate needs to be adjusted".

IV PARTICULAR POLEMICS ACCORDING THE FINANCIAL REVENUE ESTIMATES[iii]

In an op ~ ed published in the Washington Post on April 4, Lawrence Summers, a Harvard University professor who was treasury secretary from 1999 to 2001 and an economic adviser to President Barack Obama in 2009 and 2010, and

Natasha Sarin, an assistant professor of law at the University of Pennsylvania Law School and an assistant professor of finance at the Wharton School, took direct aim at the $2.75 trillion estimate and concluded that *"common-sense revenue estimates by economists who are not very deeply steeped in revenue estimation tend to be overly optimistic".* The two looked at the U.S. experience with estate tax data and concluded Warrens wealth tax would only raise about 40% of the amount estimated by Saez and Zucman. *„We suspect that to a great extent it reflects the myriad ways wealthy people avoid paying estate taxes that in some form will be applicable in any actually legislated wealth tax"* Summers and Sarin wrote. *„These include questionable appraisals; valuation discounts for illiquidity and lack of control; establishment of trusts that enable division of assets among family members with substantial founder control; planning devices that give some income to charity while keeping the remainder for the donor and her beneficiaries; tax-advantaged lending schemes; and other complex devices known only to sophisticated investors. Except for reducing a naive calculation by 15 percent, Saez and Zucman do not seem to take account of these devices".*

While neither the Tax Policy Center nor the Tax Foundation has yet released a full analysis of Warrens plan, economists at both said there is reason to believe Warrens revenue estimate is too high.

Kyle Pomerleau chief economist and vice president of economic analysis at the nonprofit, pro-businessTax Foundation, said that the assumption of 15% tax evasion/avoidance is *„actually the average avoidance for the entire U.S. tax system, which is primarily the income tax and payroll tax. These taxes are, in principle, much harder to avoid than a wealth tax because the transaction (income) is hard to game or hide from the tax authorities. There is a good record of how much you are being paid by your employer. A wealth tax, on the other hand, is much harder to enforce. For one, much of the wealth tax base does not have a market price. For example, we do not really know how much a particular privately-held business is worth because equity (stocks) in that company are not regularly traded on the open market".*

Pomerleau also warned that because the wealth tax is a significant tax on savings, it will discourage people from holding on to assets. *„This effect will reduce the potential tax base"* Pomerleau said, a trend that was not accounted for in Warrens estimate.

Howard Gleckman, a senior fellow at the nonpartisan Tax Policy Center, has similar concerns. *„First, while her plan anticipates some tax avoidance, it will be*

very difficult for the IRS to keep up with the tax planning that highly-paid lawyers and accountants can devise. With so much money at risk, the wealthy will have powerful incentives to hire smart advisers to help avoid, or at least reduce, their tax liability. Second, a large share of wealth held by the high net worth taxpayers is in the form of privately held businesses" he said. „And these are notoriously difficult to value. In effect, the IRS would have to prove that a taxpayers valuation is unreasonably low.I suspect she would collect less revenue than she predicts, but I cannot say how much less" Gleckman told.

V PARTICULAR POLEMICS FROM US PANEL [iv]

Chicago Booths Initiative on Global Markets invited its US panel to express views on three separate issues related to the wealth tax: first, how difficult it would be to enforce; second, assuming it could be enforced successfully, what would be its likely effects; and third, whether there were realistic alternatives within the existing US tax system.

Statement before the panel: Senator Warren proposed wealth tax would be much more difficult to enforce than existing federal taxes because of difficulties of valuation and the ways by which the wealthy can under-report their true wealth.

A substantial majority of respondents considered the wealth tax to be much more difficult to enforce than existing federal taxes: weighted by each experts confidence in their response, 82 percent agreed with that statement, while just 9 percent disagreed.

Some of the experts pointed to past experiences of the challenges of enforcing a wealth tax. Steve Kaplan of Chicago Booth stated that *„Where they have been tried, wealth taxes have not been successful"* and Darrell Duffie at Stanford added *„The experience in France is apparently that this is a difficult form of tax to implement".*

Berkeleys Saez and Aaron Edlin, both of whom disagreed with the statement, mentioned ways to make the wealth tax enforceable. Edlin commented on valuation issues: *„One way to avoid under-reporting with some assets is to allow anyone to buy at declared valuations. Another is large penalties".* Saez referred to the resource requirements of tax collection: *„Enforcement success depends on resources devoted to set up a systematic way to measure wealth: information sharing, norms for valuations etc".*

Statement before the panel: if successfully enforced, Senator Warrens proposed wealth tax would substantially decrease the share of wealth going to the top 0,1 percent of wealth~holders after 20 years.

Weighted by each experts confidence in their response, just under three-quarters of the panel agreed that a successfully enforced wealth tax would substantially decrease the share of wealth going to the top 0.1 percent of wealth-holders.

Larry Samuelson of Yale calculated that *„[i]f successful, taxation at rates of 2 or 3 percent, compounded over 20 years, would significantly diminish the taxed wealth"* and Saez noted, *„Wealth tax mechanically reduces returns to wealth at the top. Behavioral responses [are] likely to magnify the effect. Effect builds up over time".*

Robert Shimer at the University of Chicago, who agreed with the statement, added *„It would also lead to much of the wealth moving offshore, despite provisions against that"* while Booths Kaplan, who strongly disagreed, argued *„Pre-tax wealth inequality is driven by technology and globalization. Wealth taxes do not change those two forces".*

Statement before the panel: A public policy goal that could be accomplished with a well~enforced wealth tax could be equally accomplished with modification to existing federal taxes ~ for example revising the estate tax and|or capital gains tax.

Weighted by each experts confidence in their response, 60 percent agreed that alternative means could achieve the objectives of a wealth tax.

Among those who agreed or strongly agreed with the statement, Michael Greenstone at the University of Chicago said that *„a reform of existing taxes to match wealth tax, however, would need to do something about the stepping up of cost basis for estate taxes".* Thaler concurred *„Yes, the estate tax is a sieve. Start with that? Get rid of step up to begin with"* as did Yales Judith Chevalier: *„To use only income and capital gains taxes, a key policy lever would be eliminating the capital gains basis step up at death".*

Daron Acemoglu at MIT suggested, *„What would be most successful would be a combination of relatively high estate taxes combined with taxes on capital income".* Acemoglu also noted, in response to the first statement of the poll, regarding enforceability *„Taxing capital income at the same rate as labor income would be simpler, more effective, and much less difficult to implement".*

Robert Hall at Stanford said *„We should focus on a progressive consumption tax structured as a value-added tax“* while William Nordhaus of Yale proposed *„Start with enforcing the current laws. This would be [a] highly progressive move and should be at [the] top of [the] tax agenda, way at [the] top“.*

Among those who disagreed with alternative approaches, Saez commented *„Estate and realized capital gains taxes come decades after wealth accumulation . . . wealth tax is a useful withholding tax backstop“.*

VI INSTEAD OF THE CONCLUSIONS

After the above mentioned, our opinion is that the esteemed Emmanuel Saez and Gabriel Zucman made a very good assessment of the financial effect of the law proposal. However, the opinions of other esteemed experts are very important and valuable and should be respected. Mutual dialogue and rapprochement of the facts can only make a better and more accurate assessment of the financial impact of the law. The only accurate financial effect is possible if law comes into force. Only then can we really determine which financial estimate was the most accurate.

[i] Press Releases Senator Warren Unveils Proposal to Tax Wealth of Ultra-Rich Americans, January 24,2019, available on https://www.warren.senate.gov/newsroom/press-releases/senator-warren-unveils-proposal-to-tax-wealth-of-ultra-rich-americans

[ii] Letter by Emmanuel Saez and Gabriel Zucman to Senator Elizabeth Warren, January 18, 2019, available on https://www.warren.senate.gov/imo/media/doc/saez-zucman-wealthtax.pdf

iiiRobert Farley: Facts on Warrens Wealth Tax Plan,June 25, 2019 available on https://www.factcheck.org/2019/06/facts-on-warrens-wealth-tax-plan/

ivChicagoBoothReview, Romesh Vaitlingam: **WOULD ELIZABETH WARREN'S WEALTH TAX ACTUALLY WORK AS INTENDED?, APRIL 22,2019 AVAILABLE ON** http://review.chicagobooth.edu/economics/2019/article/would-elizabeth-warren-s-wealth-tax-actually-work-intended