What is a Wealth Tax, and Should the United States Have One?

One revenue-raising policy proposal that has recently gained national attention is a wealth tax, which would impose a levy on assets owned by an individual or household — as opposed to, for example, an income tax.

Advocates of a wealth tax argue that it would be an effective and progressive means of raising revenues while addressing wealth and income inequality and affecting only a very small fraction of U.S. households. Critics counter that a wealth tax would be difficult to enforce, would lead to tax evasion (reducing the amount of revenues actually collected), and may be unconstitutional.

This blog summarizes the concept of a wealth tax, highlights the main arguments for and against them, and looks at the experiences of certain European countries that have imposed a version of a wealth tax.

How Does a Wealth Tax Work?

A wealth tax is usually defined as an annual tax levied on the net worth, or total assets net of all debts, of an individual or household above an exemption threshold. Net worth is made up of financial assets — such as bank accounts, bonds, stocks, and mutual funds — as well as non-financial assets — such as real estate, luxury goods, and family heirlooms. Most

proposals suggest levying a wealth tax as an addition to existing forms of taxation, not as a substitute. A number of wealth tax proposals also include an “exit tax” on assets transferred abroad to curb tax avoidance.

To illustrate the basic concept, consider a simple example of a 2 percent wealth tax imposed on all individual or household net worth above $100 million (the exemption threshold). A wealthy individual with a net worth of $3 billion would be liable to pay 2 percent on the $2.9 billion in assets he or she owns above $100 million — resulting in a $58 million tax.

Example: 2 percent wealth tax with a $100 million exemption threshold on an individual with $3 billion in net worth

Assets	Wealth Tax Rate	Wealth Tax Owed
First $100 million	0%	$0
Remaining $2.9 billion	2%	$2.9 billion x 2% = $58 million
TOTAL		**$0 + $58 million = $58 million**

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If an additional 1 percent surcharge were imposed on all net worth above $1 billion, the individual would again pay nothing on his or her first $100 million in assets, 2 percent on the next $900 million, and now 3 percent on the following $2 billion in total net worth. Under this plan, the individual would owe $78 million in total wealth taxes.

Example: 2 percent wealth tax with a $100 million exemption threshold and surcharge above $1 billion on an individual with $3 billion in net worth

Assets	Wealth Tax Rate	Wealth Tax Owed
First $100 million	0%	$0
Next $900 million	2%	$900 million x 2% = $18 million
Remaining $2 billion	3%	$2 billion x 3% = $60 million
TOTAL		$18 million + $60 million = $78 million

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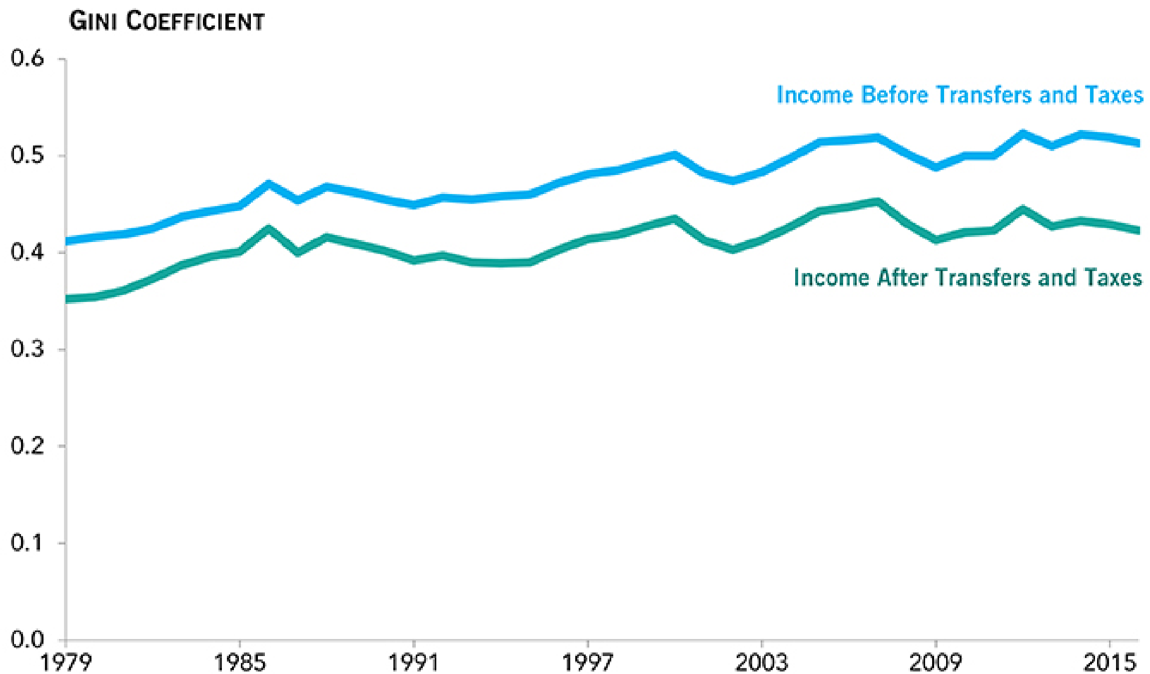
Arguments Made in Favor of a Wealth Tax

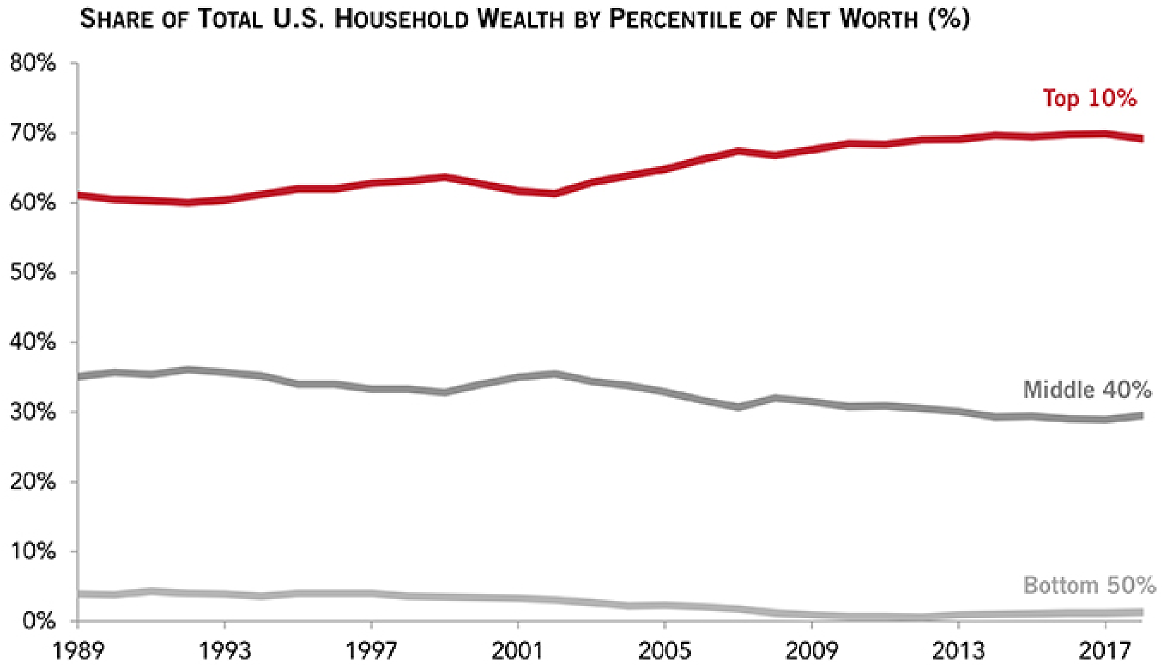
Proponents of the wealth tax argue that it could help address the United States' rising wealth and income inequality while also generating revenues.

A Wealth Tax Could Make the Tax System More Progressive and Mitigate the Effects of Rising Inequality

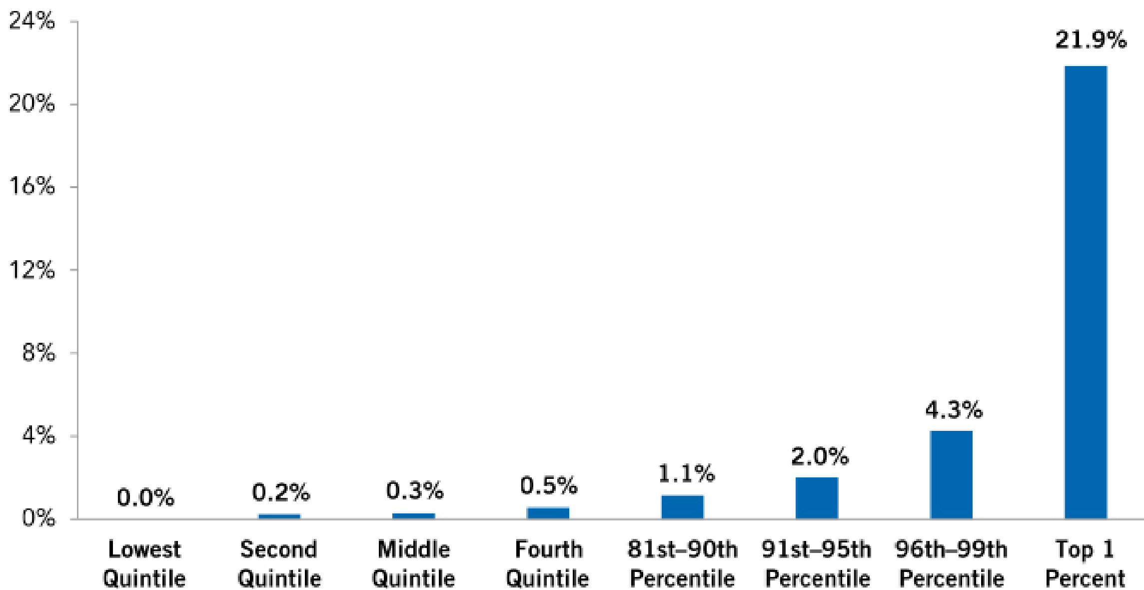
One feature of the wealth tax that has appealed to academics and policymakers is its potential to address both after-tax income inequality and the wealth gap in the United States. Economists quantify income inequality using the Gini coefficient, an index where 0 represents perfect equality and 1 represents perfect inequality. There are various methods for calculating the Gini coefficient — for example, if measuring income before transfers and taxes, inequality in the United States increased from 0.41 in 1979 to 0.51 in 2016, according to the Congressional Budget Office; after adjusting for taxes and transfer payments, the measure rose from 0.35 in 1979 to 0.42 in 2016. In both cases, the data show that inequality has increased in the United States. High levels of inequality are associated with negative social and economic consequences, such as a loss of confidence in institutions, weaker social cohesion, and slower economic growth.



In addition to rising levels of income inequality, the United States also has considerable wealth inequality. Whereas income inequality refers to the unequal distribution of annual household income, wealth inequality is the difference in the total net worth of households. According to the Federal Reserve, the wealthiest 10 percent of households saw their share of the nation's total wealth grow from 61 percent at the end of 1989 to 70 percent in 2019. Conversely, the middle 40 percent and bottom 50 percent both saw their share of wealth decrease over the same time period.



Certain elements of the tax code — like disparate tax rates for different types of income — contribute to the country's rising inequality. For example, capital gains — which are taxed at a lower rate than wages and salaries — represent a larger share of pre-tax income for the nation's wealthiest households. Data from CBO show that income from capital gains represented nearly 22 percent of the total pre-tax income for the top 1 percent of households ranked by income, compared to less than 1 percent for households in the middle and bottom income quintiles. Intergenerational income transfers also often go untaxed or are taxed lightly. Estate taxes, for example, only require a filing if the combined gross assets exceed $11.4 million in value; such taxes apply to less than 0.1 percent of all decedents.



Proponents of a wealth tax highlight its potential to enhance the progressivity of the tax code. University of California Berkeley professors Emanuel Saez and Gabriel Zucman estimate that just 75,000 households, or 0.06 percent of all U.S. households, would be subject to a wealth tax if the exemption threshold was set at $50 million. Revenues raised through a wealth tax could help fund programs that invest in a more inclusive economy and benefit lower income Americans, effectively evening the playing field and giving a boost to those in need.

A Wealth Tax Would Raise Revenues

Another argument made in favor of a wealth tax is that it could raise substantial revenues to address the daunting outlook for the deficit or provide funding for other initiatives. Revenue estimates for a wealth tax differ based on the components of the proposals and on assumptions about enforcement and evasion. For example, Saez and Zucman estimate that in 2019, $9.4 trillion of U.S. household wealth, or 51 percent of GDP, would be subject to a wealth tax with a $50 million threshold. Using those estimates, if a 1 percent wealth tax were imposed on all assets comprising that base and no evasion occurred, the tax would raise an additional $94 billion, or about 3 percent of total federal revenues in 2019; if enforcement were weak and base erosion were 50 percent, the amount of revenues raised would be half as large.

Arguments Made Against a Wealth Tax

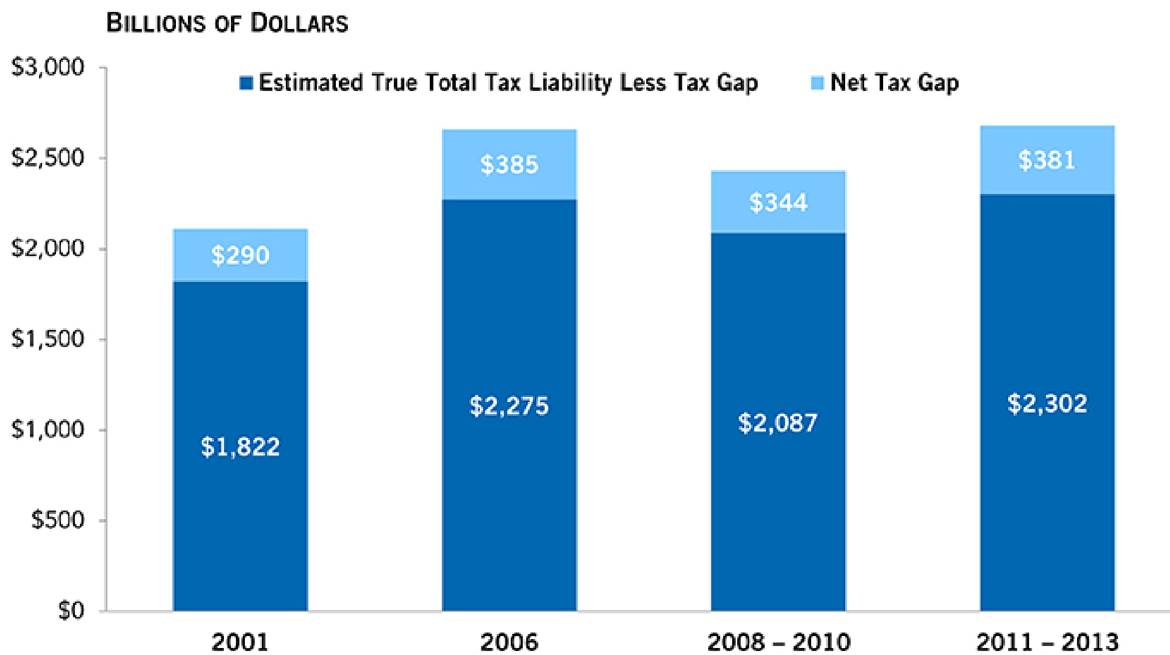
Critics of the wealth tax contend that it would be cumbersome to enforce, ineffective in raising revenues, and possibly unconstitutional.

Enforcing a Wealth Tax would be Difficult

One of the main critiques of a wealth tax is that they are difficult to enforce. For starters, the Internal Revenue Service (IRS) would need increased funding to bolster its auditing capacity to accurately assess the net worth of each of the country's richest households. Indeed, many observers believe that a successful implementation of a wealth tax must be accompanied by increased funding to the IRS to cover the resources needed to track and enforce the tax.

As it stands, the IRS struggles to enforce tax laws already on the books. According to Bill Gale, an economist and author of *Fiscal Therapy*, the amount of unpaid taxes that were legally due in 2017 was about $535 billion, owing to underreporting on the part of taxpayers and underfunding for the IRS. Enforcing a wealth tax is further complicated by the need for IRS auditors to assess the value of a wealthy household's financial *and* non-financial assets like yachts, paintings, homes, etc., which is likely to involve a degree of subjectivity and dispute.

The IRS does not collect all of the taxes it is owed each year



SOURCE: Internal Revenue Service, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011 – 2013*, September 2019.
NOTES: The net tax gap is defined as the amount of true tax liability that is not paid on time and is not collected subsequently, either voluntarily or as the result of enforcement activities. Data for 2008 – 2010 and 2011 – 2013 reflect estimated average compliance rates and associated tax gaps covering three tax years.

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A Wealth Tax Might Not Raise as Much as Predicted

Critics of a wealth tax also point to potential gaps for the wealthy to exploit. For example, assuming the current tax exemption for private foundations remains in place, many wealthy people could shift their assets into foundations where they would be sheltered from the IRS. Similarly, critics predict that the imposition of a wealth tax would simply lead many wealthy families to use legal structures to abdicate direct ownership of assets while maintaining practical control over them, such as through trusts and nonprofits. Wealthy families also have substantial flexibility in their mobility, so critics predict that a wealth tax could drive America's fortunes out of the country and weaken the U.S. tax base.

Indeed, a number of economists have projected that a U.S. wealth tax would raise only one-eighth of the amount that economists like Saez and Zucman have projected. Instead of a wealth tax, those critics argue that the best way to get the rich to pay their fair share of taxes is through reforms to the current income tax system, such as closing tax shelters, changing capital gains laws so that heirs are liable to pay tax on the gains not realized during the benefactor's lifetime, and adjusting the provisions of the estate tax.

A Wealth Tax Might Not Be Constitutional

Some critics have suggested that a wealth tax would be unconstitutional. The Constitution says that direct taxes must be apportioned by state population and it may not be feasible to do so with a wealth tax. An 1895 ruling by the Supreme Court stated that an income tax was a direct tax and would therefore need to be apportioned to be valid. It took ratification of the 16th Amendment in 1913 to allow the Congress to impose an income tax. Although a number of scholars have insisted that the wealth tax is constitutional, the ultimate ruling on the issue is unclear.

How Have Wealth Taxes Worked in Other Countries?

A number of European countries have implemented versions of a wealth tax with varying degrees of success. In 1990, 12 member nations of the Organisation for Economic Cooperation and Development (OECD) had net wealth taxes. By the end of 2018, just three member countries (Norway, Spain, and Switzerland) still imposed an annual net wealth tax, while Belgium, Italy, and the Netherlands levy wealth taxes on certain assets but not on total net worth. An OECD report explains that net wealth taxes are much less common than they used to be among member countries because of administrative difficulties, noncompliance, and undesired emigration; such issues ultimately led countries like Austria, Finland, Germany, and Sweden to repeal their wealth tax laws.

The specifics of the existing wealth taxes in Europe vary between countries. Norway, for example, taxes its wealthiest households at 0.85 percent annually on wealth exceeding €150,000, while Spain and Switzerland have progressive systems. Spain taxes its wealthiest citizens by between 0.2 and 2.5 percent per year on wealth above €700,000 and Switzerland between 0 and 50 percent per year. Unlike the national wealth taxes in Norway and Spain,

Switzerland’s net wealth tax is collected at the local level. Most of the European countries that impose a wealth tax also offer exemptions. For example, Spain allows for a €300,000 individual exemption for a primary residence while Norway exempts 75 percent of the value of an individual’s primary residence.

The revenues raised from wealth taxes in those countries represented relatively modest proportions of their total revenues. Spain’s wealth tax accounted for 0.5 percent of total revenues in 2018, while Norway’s wealth tax accounted for 1.5 percent of revenues. Switzerland’s wealth tax made up 4.8 percent of total revenues in 2018; however, that is due to lower exemption thresholds and a comparatively high percentage range depending on the locality. As a comparison, the amount of revenues raised by the Swiss wealth tax in 2018 equaled 1.3 percent of GDP; if the United States were able to achieve the same percentage, it would equal roughly $263 billion in 2018, which is $58 billion more than the government raised from the corporate income tax in 2018.

Only three OECD countries impose an annual net wealth tax

OECD Countries with a Net Wealth Tax	Rate	Exemption Threshold	% of Total Tax Revenues (2018)
Norway	0.85 percent	1.5 million kr	1.5 percent
Spain	0.2 – 2.5 percent	€700,000*	0.5 percent
Switzerland	0 – 50 percent	Varies by Canton	4.8 percent
OECD Countries with Select Wealth Taxes	**Rate**	**Exemption Threshold**	**Applies To**
Belgium	0.15 percent	€500,000	Securities
Italy	0.2 percent	N/A	Some Financial Assets
Italy	0.76 percent	N/A	Some Foreign Properties
Netherlands	0.58 – 1.68 percent	N/A	All But Primary Residence and Company Interest

SOURCES: EY, Worldwide Estate and Inheritance Tax Guide 2019, February 2019; and Organisation for Economic Cooperation and Development, OECD Tax Revenue Statistics, December 2019.
NOTE: *Exemption threshold may be lower in some regions.
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Conclusion

Most economists agree that the tax system is a useful vehicle for addressing the nation’s income and wealth inequality, but disagree on an optimal approach. The OECD concluded its report noting that “from both an efficiency and equity perspective, there are limited

arguments for having a net wealth tax in addition to broad-based personal capital income taxes and well-designed inheritance and gift taxes."

While the debate surrounding the merits and pitfalls of a wealth tax is likely to go on, the national debt continues to rise to historic levels, highlighting the need for bold and creative policy solutions that address the country's systemic inequalities while also putting the nation on a sustainable course for the future.