

Taxing the Wealth of the Poor:

Evidence from the Danish Old-Age Support Asset Test

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Motivation

Academics and policymakers are increasingly discussing wealth taxes on the rich

(e.g. Global Minimum Tax on Billionaires)

The low wealth of the poor is often subject to implicit taxation through asset testing of government transfers

(e.g. Medicaid, food stamps, TANF etc)

This creates incentives to hold little wealth and vulnerability to economic shocks

This paper

This project: How does asset testing of government transfers affect the wealth distribution at the bottom?

Our laboratory is Denmark:

- **Policy:** Elderly receive \$3k check if low liquid assets
- **Data:** Tax returns and customer records of large bank

Method: Compare wealth distributions - Those who satisfy other criteria (income, age) vs those who fail one

- Same cohort before vs after becoming age-eligible

Preview of results

Large real effect of asset testing government transfers on wealth distribution at the bottom

- Large but diffuse bunching below threshold
- No such bunching for the ineligible in terms of age and income
- Bunching moves when policy reforms shifts threshold
- Bunching becomes sharper with time of exposure
- Bunching through the year but most pronounced in December

Treatment effect on liquid assets of around -20% at the threshold

Background, Data and Method

The old-age check

Public pensions in Denmark are generally subject to an **income test** with phase-out above threshold:

- \$12k basic pension (high income threshold)
- \$14k supplement (low income threshold)
- \$3k old-age check (low income threshold)

The old-age check is additionally subject to a sharp **asset test**: liquid assets < \$14k

Asset test creates a notch with strong incentives for low-income retirees to keep few liquid assets

More details

Definition of liquid assets:

- banks accounts, financial assets and cash
- no real estate assets
- no netting of liabilities

Timing:

- old-age check for year t paid out in January in t
- asset test applied end-of-year $t-1$
- admin data from end-of-year $t-2$ ("default")
- self-reported data by end-of-year $t-1$ ("reported")

Possible reconciliations in the course of t

Data

Administrative data (annual):

- demographics
- general wealth information from tax return
- self-reported data specifically for asset test

Bank data (monthly):

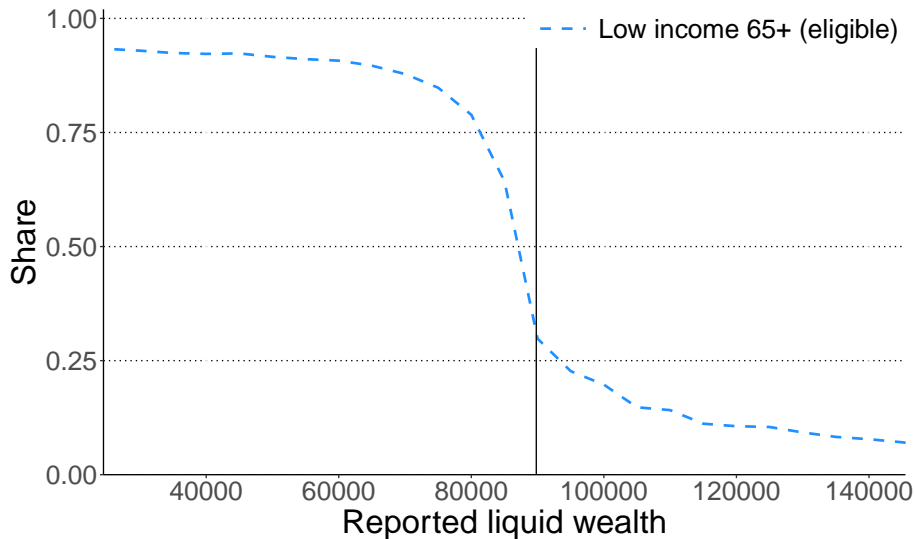
- liquid balances
- spending
- cash withdrawals

The bank sample is largely representative and the data largely complete

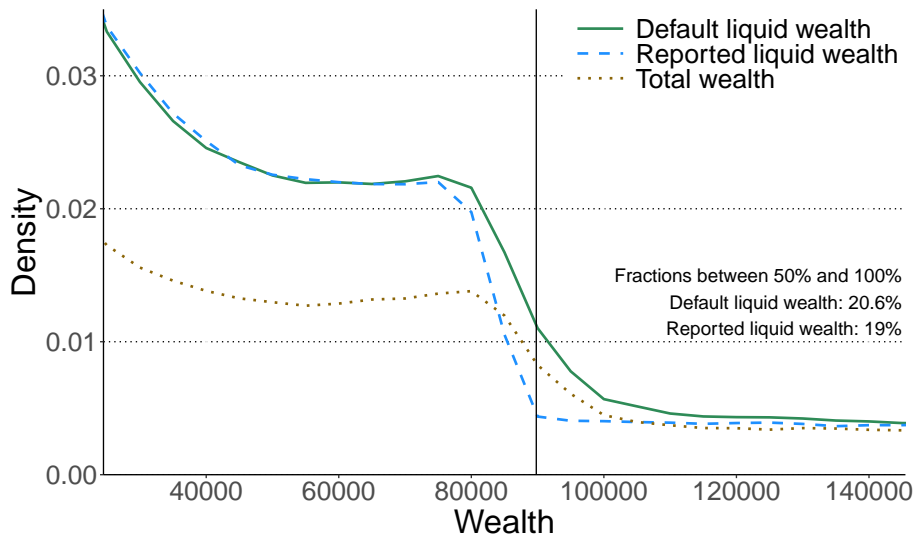
Results

First stage: 60ppt change at threshold

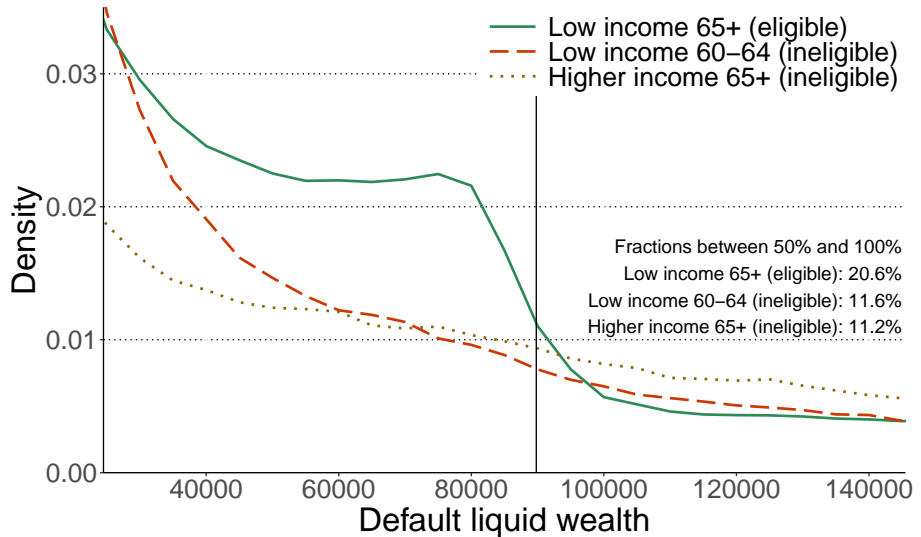
(fuzzy due to imperfect measurement)



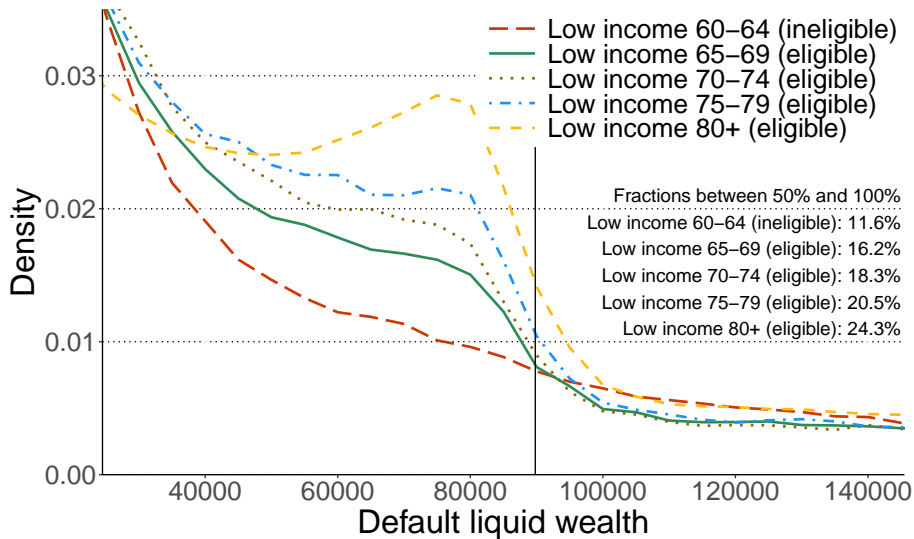
Main result: Strong but diffuse bunching in liquid assets below threshold



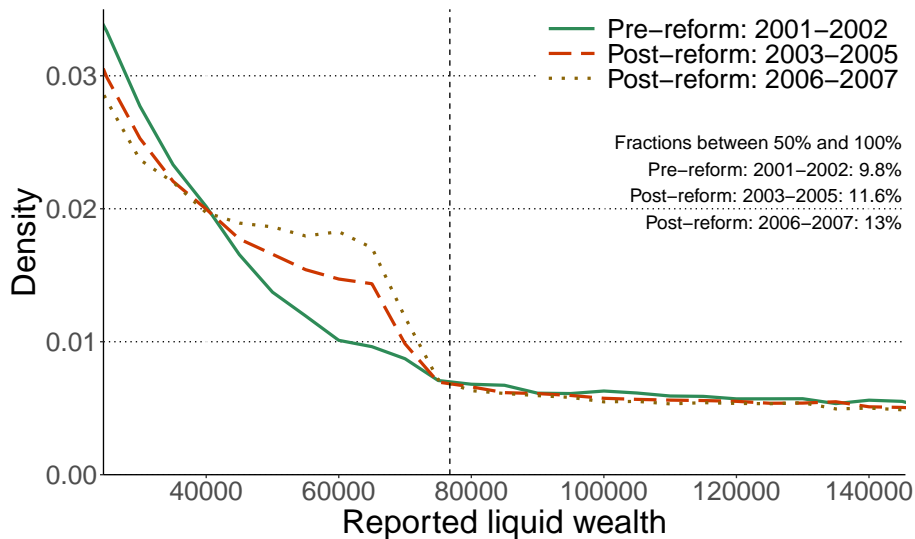
Two simple comparisons: age-ineligible and income-ineligible



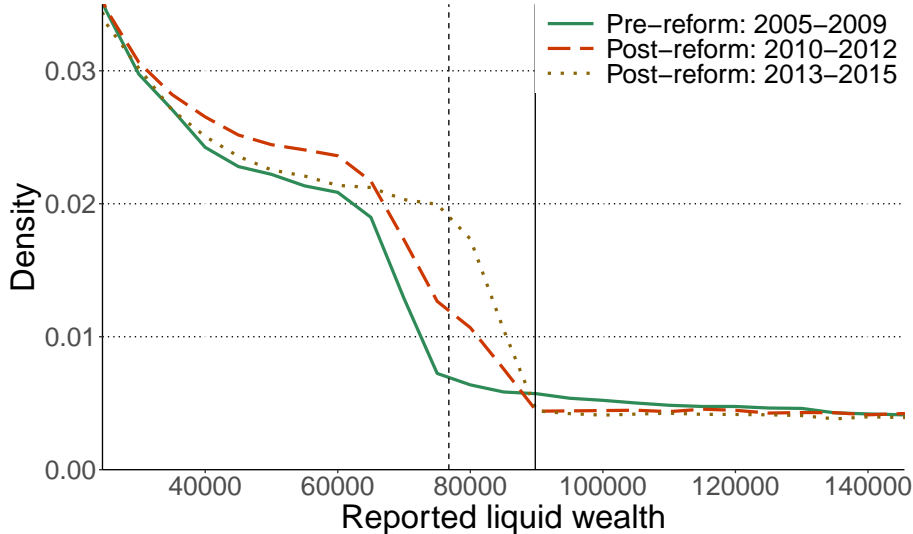
Age dynamics in the wealth distribution



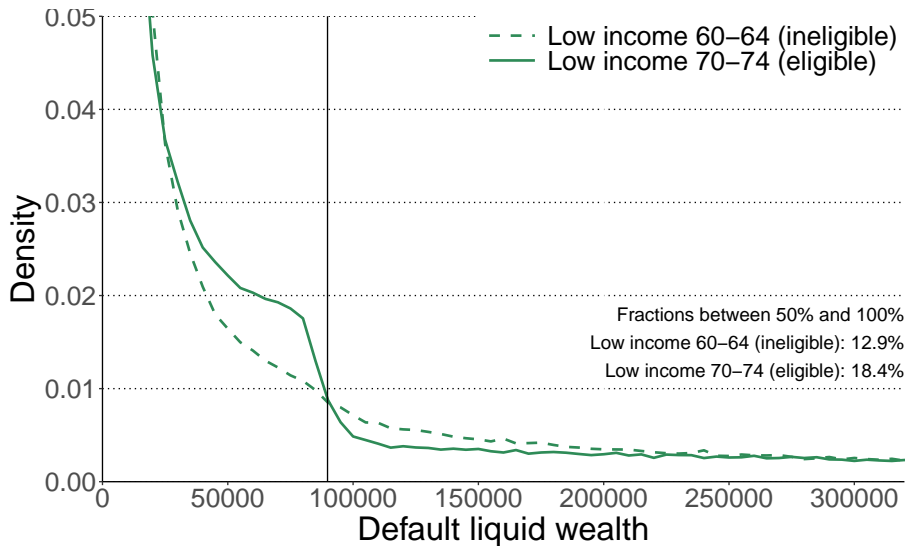
Reform analysis I: Introduction of the old-age check



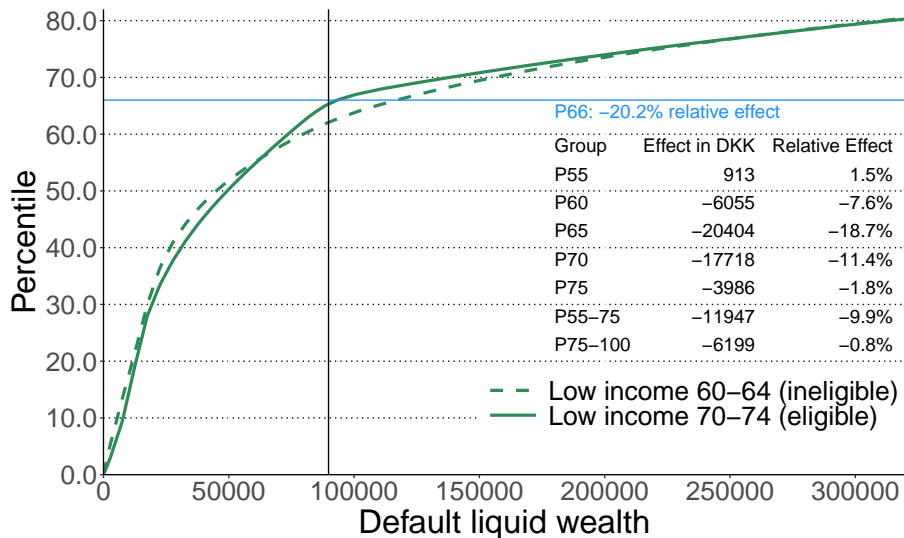
Reform analysis II: Shifting the asset threshold



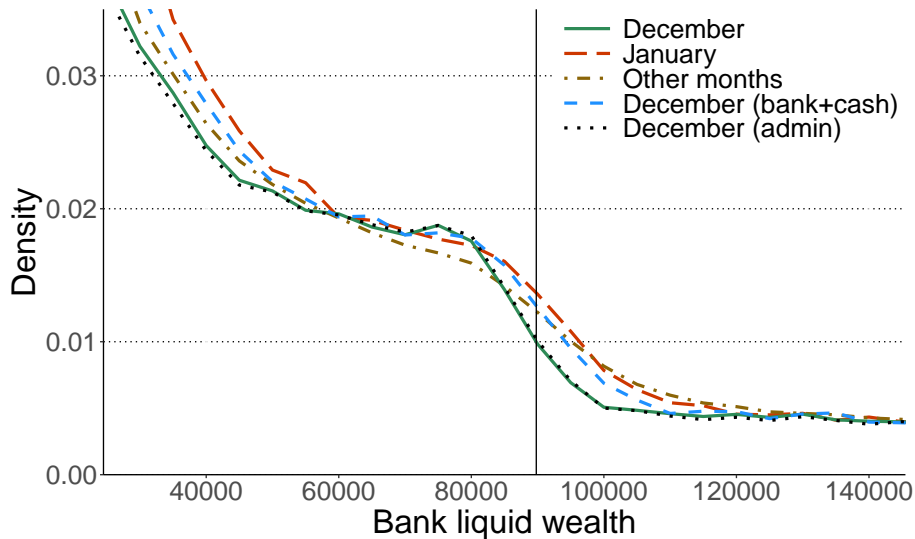
Treatment effects: actual vs counterfactual densities



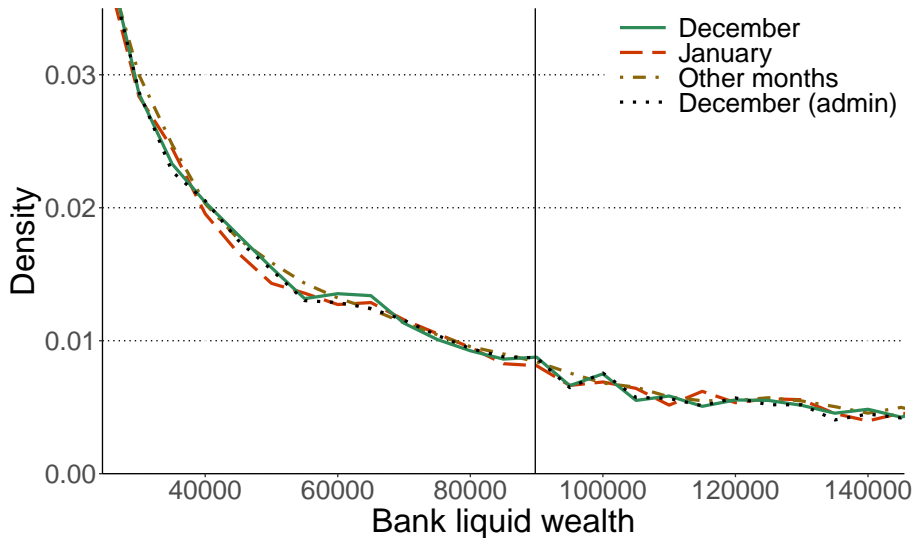
Treatment effects: actual vs counterfactual cumulative distributions



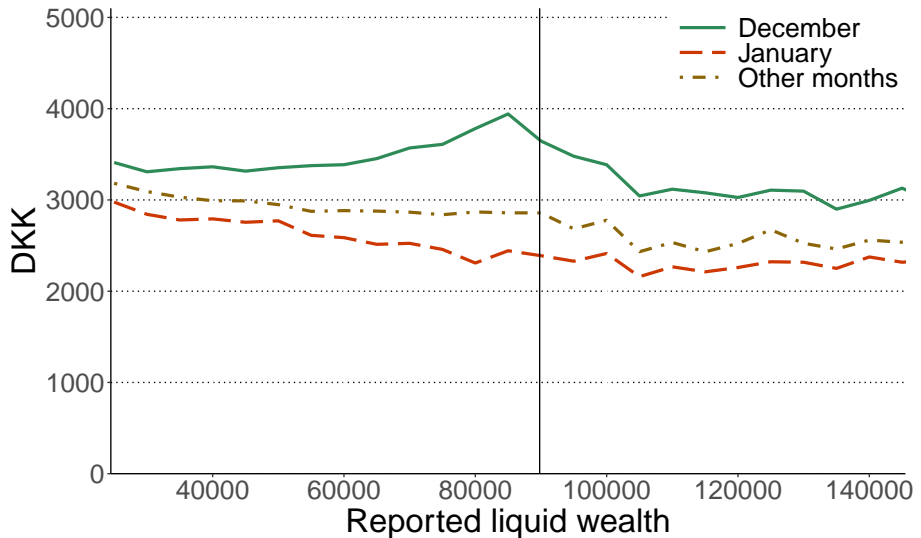
High-frequency dynamics: Bunching persistent through the year



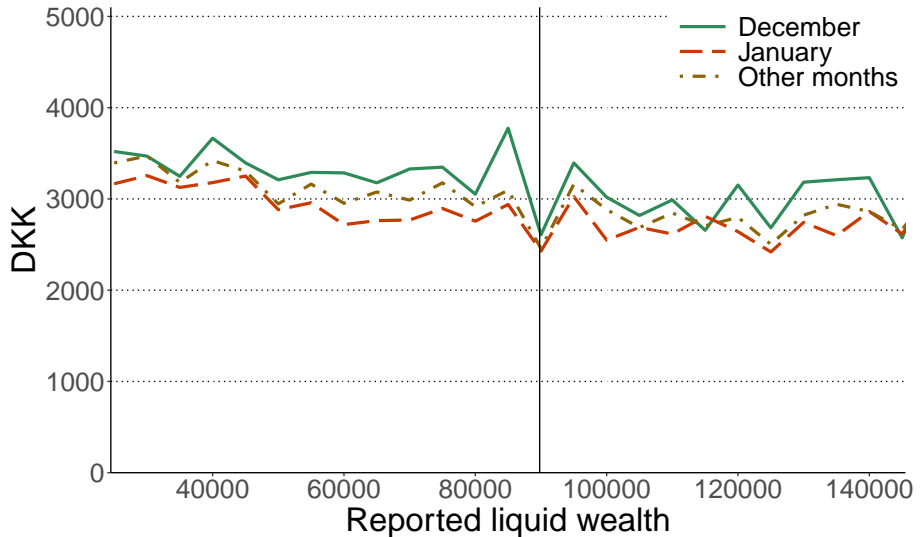
No seasonality for the age-ineligible



Cash withdrawals, over the wealth distribution and over the year



No similar pattern for the age-ineligible



Conclusion

- Asset test associated with the old-age-check imposes a large implicit wealth tax on the poor
- Clear behavioral responses: compression of the wealth distribution below the threshold
- Treatment effect of around 20% at the threshold
- Inefficiency because low-income elderly become underinsured against economic shocks