

WEALTH[‡]

Wealth Taxation: Lessons from History and Recent Developments[†]

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Since the late 2010s, there has been renewed debate about the merits and demerits of progressive wealth taxation. This debate has largely been motivated by the increase in wealth concentration in recent decades. In the United States, the share of total household wealth owned by the top 0.0001 percent wealthiest Americans—a group that includes 18 individuals with more than \$50 billion in wealth in 2021—has been multiplied tenfold since *Forbes* started publishing data on the richest Americans in 1982. Wealth concentration has increased particularly fast during the COVID-19 pandemic (see Figure 1). All estimates show a dramatic increase in wealth concentration since the late 1970s (see Saez and Zucman 2020 for a discussion of the data and reconciliation of the various estimates). Moreover, as wealth concentrated, the ratio of wealth to national income doubled from less than three in the late 1970s to over six in 2021. Top-end wealth is large relative to the economy and therefore a sizable potential tax revenue source (Saez and Zucman 2019a).

To shed light on the practicality and desirability of taxing wealth, this paper studies the historical experience with wealth taxation in Europe. Using new research on the distribution of wealth over time in Europe, we show that the European

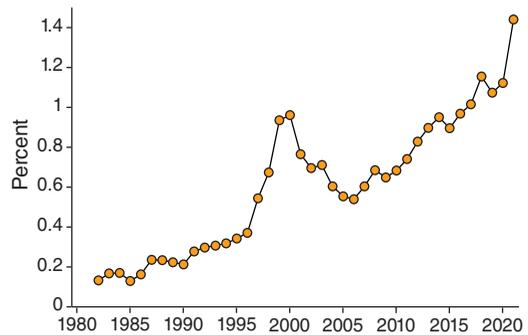


FIGURE 1. TOP 0.00001 PERCENT WEALTH SHARE IN THE UNITED STATES

Notes: This figure shows the share of wealth owned by the top 0.00001 percent wealthiest tax units in the United States from 1982 to 2021. The top 0.00001 percent includes 18 tax units in 2021. Their wealth is from *Forbes*; the total household wealth denominator is from the Federal Reserve Financial Accounts.

Source: Saez and Zucman (2020), updated.

wealth taxes had a narrow base, due to large exemptions, tax avoidance, and tax evasion. We explain why such exemptions were granted and how they undermined European wealth taxes, leading in many cases to their repeal.

Drawing lessons from this experience, we conclude by laying out the design and enforcement features that are required for a successful wealth tax in the twenty-first century. We compare this ideal wealth tax to proposals recently made in the United States.

I. European Taxes: A Narrow Base

We focus on progressive wealth taxes on households. Such a wealth tax is an annual tax on assets net of debts above an exemption threshold, often with graduated rates. Assets include

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TABLE 1—WEALTH TAX REVENUES IN EUROPE IN 2016: ACTUAL VERSUS THEORETICAL

	Fraction liable (%)	Nominal marginal tax rates (%)	Tax revenue (% GDP)	Revenue from 1% tax on top 1% (% GDP)
Spain	0.5	1 to 2.5	0.18	0.96
Norway	13	0.85	0.43	0.86
France	1	0.5 to 1.5	0.22	0.83
Switzerland	25	0.2 to 0.5	1.03	1.36

Notes: This table reports statistics for four European countries that still imposed wealth taxes in 2016 (OECD 2018). “Fraction liable” reports the approximate fraction of households liable for the tax. “Nominal marginal tax rates” reports the range of graduated marginal tax rates that apply to the taxable base (there is regional variation in Spain and Switzerland, so the most common ranges are reported in these cases). “Tax revenue” reports the wealth tax revenue as a percent of GDP (from OECD 2018). “Revenue from 1 percent tax on top 1 percent” reports the tax revenue potential (as a percent of GDP) of a wealth tax of 1 percent applied above an exemption threshold equal to the ninety-ninth percentile of the wealth distribution (individual adults with equal split for married couples). We assume that wealth is measured at market value for all assets with no exemption and no tax evasion. Data on the wealth distributions and wealth-to-GDP ratios are from the World Inequality Database.

both financial assets (such as stocks and bonds) and nonfinancial assets (such as housing). This is in contrast to more common property taxes, which only tax housing (with no deductions for debts) and exempt financial assets.

The European continent has a long experience with progressive wealth taxes on households. In 1985, according to statistics collected by the Organisation for Economic Co-operation and Development (OECD 2018), 11 European countries had such a wealth tax, including Germany, France, Spain, Sweden, and Denmark. In most cases, these were old taxes, first created in the late nineteenth and early twentieth century. The taxes were based on self-reported wealth and applied above an exemption threshold often located around the ninetieth to ninety-ninth percentile of the wealth distribution, though some were broader (i.e., on the top 25 percent in Switzerland). Rates typically ranged from about 0.5–1 percent above the exemption threshold to about 2–3 percent for the largest fortunes.

In practice, a large fraction of the wealth of taxable individuals was exempt or taxed at only a fraction of its market value. This was the case for equity in private businesses (a key source of wealth at the top of the wealth distribution) and for primary homes (the main source of wealth just above the exemption threshold). Moreover, most countries had ceiling mechanisms whereby the amount of wealth tax owed could not exceed a fraction of taxable income for the individual income tax (see Jakobsen et al. 2020 and Bach et al. 2022 for a description of these rules in the Danish and French contexts).

To quantify the fraction of wealth that was effectively taxed, we proceed in three steps. We start with the wealth distributions available on the World Inequality Database (WID.world). We then simulate the mechanical revenue of a wealth tax at a marginal rate of 1 percent on the top 1 percent wealthiest adults (that applies only above an exemption threshold equal to the ninety-ninth percentile of the wealth distribution). Finally, we compare the theoretical revenues to the amounts effectively collected as reported by the OECD in its government revenue statistics (revenue code 4210, “individual recurrent taxes on net wealth”). The results are shown in Table 1.

The main finding is that the European wealth tax collected little revenue relative to a simple 1 percent marginal tax on the top 1 percent. In Western Europe, the top 1 percent wealth share is typically around 25 percent. The average wealth above the ninety-ninth percentile is typically around three times the ninety-ninth percentile (corresponding to a Pareto parameter of 1.5). Therefore, a 1 percent wealth tax above the ninety-ninth percentile collects about two-thirds of the top 1 percent wealth. Furthermore, the wealth to gross domestic product (GDP) ratio in Western Europe is pretty high, around five or six in recent years. Hence, a 1 percent wealth tax above the top 1 percent threshold raises approximately 1 percent of GDP ($25 \times (2/3) \times 6 = 1$). In the United States, the revenue potential is even higher, as the top 1 percent wealth share is substantially higher at about 35 percent.

Consider the case of France. In 2016, about 351,000 tax units (with more than €1.3 million in net wealth) paid the wealth tax, or about 1 percent of all tax units. The top 1 percent owned about 25 percent of total household wealth, or about €3 trillion, of which €2 trillion was taxable.¹ A 1 percent marginal tax rate on the wealth of the top 1 percent would thus have generated about €20 billion in revenues (0.8 percent of GDP). Yet that same year, the wealth tax yielded only €5.1 billion (0.2 percent of GDP), i.e., 4 times less. Spain has a level of tax base erosion similar to France. Even countries such as Norway or Switzerland that tax a pretty large fraction of their populations (over 10 percent) fail to raise as much as our theoretical 1 percent tax on the top 1 percent, implying that they also suffer from base erosion.

A recent study illuminates the reasons why the French wealth tax generated little revenue. By matching individual tax returns to business ownership and tax data, Bach et al. (2022) estimate the total amount of wealth owned by wealth tax payers, including the tax-exempt business assets of owner managers. They show that the exemption of owner-managers' equity wealth dramatically reduced the base of the tax. The effect is concentrated at the top of the wealth distribution. For the top 0.001 percent (the 370 wealthiest tax units), this exemption reduced the tax base by a factor of 10, reducing the effective wealth tax rate from the theoretical rate of 1.5 percent to about 0.15 percent.

The tax ceiling mechanism, which capped the total amount of wealth plus income tax owed at 75 percent of taxable income for the individual income tax, also played a major role in reducing effective tax rates. Bach et al. (2022) show that even if the equity wealth of owner-managers had been taxed, the effective rate at the top would have still been around 0.3 percent only, because the wealthiest taxpayers reported little taxable income on their individual income tax return (e.g., by retaining profits in the corporations they own, often using holding companies to do so). As a result, despite the wealth tax, the wealthiest taxpayers had low effective tax rates relative to their true economic income (i.e., income

including profits retained in companies), of only 2–3 percent when including individual income taxes and wealth taxes. As a result, the heaviest tax on the super rich in France ends up being the corporate tax, which taxes business profits at source with a flat rate.

In sum, European wealth taxes were anything but comprehensive taxes on net wealth. In some cases such as France, the law was written such that billionaires (including large shareholders of listed companies) were effectively exempt. It was as if the United States had had a wealth tax exempting Jeff Bezos, Elon Musk, and Mark Zuckerberg.

II. Why Such a Narrow Base?

Three main reasons can explain the base erosion of European wealth taxes.

First, because the taxes started relatively low in the wealth distribution (typically below \$1 million), they affected a fraction of the upper middle class, including taxpayers whose main source of wealth was housing. For these taxpayers, the wealth tax was akin to a property tax. Property taxes are unpopular because they can create liquidity issues (e.g., Wong 2020). This led to a demand for exemption for primary homes and other assets that may not generate taxable income, such as artwork. Other taxpayers were able to use liquidity concerns to lobby for additional exemptions, such as reduced rates for owner-managers and equity in private businesses. This process ended up benefiting the ultrawealthy the most.²

A similar process has been at play in the United States with the estate tax. “Small family farms” were successfully used by opponents of the estate tax to advocate for its reduction and repeal in the early 2000s. The weakening of the estate tax disproportionately benefited large fortunes rather than small businesses, which are largely exempt from the tax due to its high exemption threshold.

Second, EU countries never attempted to address the issue of tax competition whereby the wealthy can escape the wealth tax by moving abroad. While citizens in the United States are taxable wherever they live, taxation in other

¹As wealth is Pareto distributed, about a third of the wealth of the top 1 percent is below the exemption threshold, and two-thirds (i.e., 2 trillion) is above (see Saez and Zucman 2019a).

²See, e.g., Alvaredo and Saez (2009) for the case of Spain, which introduced such an exemption in 1994.

countries is linked to residency. To avoid paying the wealth tax, rich Europeans could simply move abroad. The threat of expatriation was a major argument used to abolish the wealth tax in, for example, Sweden and France.

In principle, one could imagine a system where countries would keep taxing their expatriate after they leave, perhaps for a number of years that could depend on the number of years these expatriates have been tax residents in the first place. Tax competition is a policy choice, not a law of nature (Saez and Zucman 2019b).

Last, there was a failure of tax enforcement. European wealth taxes were based on self-reported information, in contrast to income taxes, which use extensive information reporting from employers, financial institutions, and other payers. Until 2017–2018, there was no automatic exchange of bank information between financial institutions in tax havens (e.g., Swiss banks) and European countries' tax authorities, making it easy for taxpayers to hide assets offshore. A recent study based on leaks from offshore banks (the "Swiss Leaks" from HSBC Switzerland and the Panama Papers) found that in 2007, the wealthiest Scandinavians evaded close to 20 percent of their taxes through hidden offshore accounts (Alstadsæter, Johannesen, and Zucman 2019).

In sum, the reasons for the failure of European wealth taxes are political, not economic. Choices were made to largely exempt the wealthiest taxpayers, allow tax competition, and limit enforcement. While these choices were sometimes supported by economic arguments, there is no fundamental economic reason why billionaires should be exempted from wealth taxes, nonresidents untaxed, and enforcement weak. Other choices could be made in the future.

III. Design of a Successful Wealth Tax

In light of this history, a number of ingredients appear helpful to make wealth taxes work in the twenty-first century.

First, focusing the tax on the ultrawealthy can help deflect lobbying for base erosion. This can be achieved by choosing a high exemption threshold, thus focusing the tax on taxpayers who unambiguously have a high ability to pay and are wealthy enough to not face liquidity issues.

Second, comprehensive information reporting and prepopulated returns are critical to maximize tax compliance. A key lesson from the literature on tax evasion is that compliance is high when income is third-party reported and low when it is self-reported (e.g., Kleven et al. 2011). The same financial institutions that report income to the Internal Revenue Service (IRS) could be asked to report account balances. Modern tax authorities have access to a wide range of information, including business balance sheets, allowing them to value large private businesses. Small private businesses can be valued using formulas (such as multiples of income and assets, as done in Switzerland).

Last, in case there is disagreement in the valuation of private businesses, taxpayers could be allowed to pay in kind, with shares. The shares would then be auctioned off by the government, thus creating the missing market. Since corporate ownership is divisible in the form of shares, payments in kind are always an option for owners of large businesses, which are rarely owned by a single person, especially the largest ones. This makes wealth taxes on corporate stock easier to administer than taxes on real estate, which is not as easily divisible.

Proposals made at the end of the 2010s in the United States generally follow these principles. In 2019, Senator Elizabeth Warren proposed a wealth tax at a rate of 2 percent above \$50 million and 3 percent above \$1 billion. Less than 0.1 percent of tax units in the United States would be liable for this tax (as opposed to about 1 percent in, e.g., the French wealth; see Table 1). In contrast to European wealth taxes, such a tax would thus be focused on the ultrawealthy. The proposal came with a large 40 percent tax on wealth upon citizenship renunciation, dramatically reducing the scope for tax competition. It was also accompanied by proposals to increase tax enforcement (with high audit rates at the top), drawing on the extensive information available to the IRS—including reports from foreign financial institutions since the passing of the Foreign Account Tax Compliance Act in 2010.

If well-enforced, such a tax would substantially increase the progressivity of the US tax system. As shown by Figure 2, it would increase the effective tax rate of the 400 wealthiest Americans from about 20–25 percent in 2018 to about 45 percent. Despite involving less than

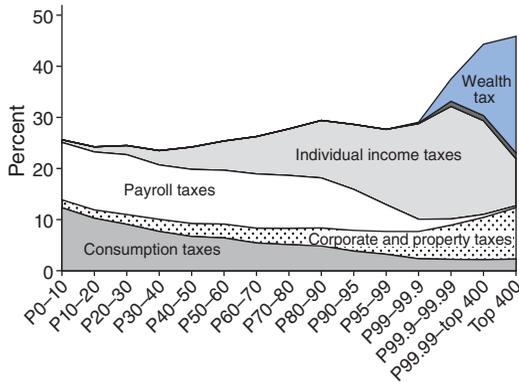


FIGURE 2. TAX RATES BY INCOME GROUP
(PERCENT OF PRETAX INCOME)

Notes: The figure shows effective tax rates in the United States expressed as a percent of pretax national income for the various groups of the pretax income distributions. Taxes at all levels of government (federal, state, and local) are included. The blue area shows the effect of a well-enforced wealth tax at rate of 2 percent above \$50 million and 3 percent above \$1 billion.

Source: Saez and Zucman (2019b)

0.1 percent of the population, the revenue potential is significant: about 1 percent of GDP (Saez and Zucman 2019a).

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