Testimony of

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Creating Opportunity through a Fairer Tax System

Chairperson Warren, Ranking Member Cassidy, and distinguished members, I appreciate the opportunity to participate in this hearing about creating opportunity through a fairer tax system. I am an associate professor at the Kenan-Flagler Business School at the University of North Carolina. I am also the research director of the UNC Tax Center.[1] My research focuses on corporate and individual taxation, and how taxation affects taxpayer behavior.

My testimony will focus on perceptions of fairness in the tax code and recent proposals to fix such perceived unfairness; specifically, a tax on book income and the wealth tax. My main message is that corporations and individuals remit the taxes they do, including in situations some perceive as unfair,[2] frequently because of explicit allowances in the tax code.[3] In other words, the largest holes in our national tax revenue bucket are ones Congress has, itself, poked, and not the product of elaborate tax planning schemes, as is a current misperception. If members of Congress seek to change the tax system, they should do so in ways that make the tax code simpler, rather than layer on additional taxes that will add complexity to the tax code, be difficult to administer, have unintended negative consequences, and, ultimately, likely be eventually eliminated, making our

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[1] The opinions expressed here are my own, and not that of any organization with which I am currently, or have been, affiliated, in any capacity (the University of North Carolina, the Kenan-Flagler Business School, the UNC Tax Center, the Internal Revenue Service, etc.).

[2] Fairness is often used in reference to our tax system or the tax code. Presidents Joe Biden (https://joebiden.com/two-tax-policies/), Donald Trump (https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf), Barrack Obama (https://obamawhitehouse.archives.gov/issues/taxes), George Bush (https://www.treasury.gov/press-center/press-releases/Documents/report30652.pdf), and Bill Clinton (https://clintonwhitehouse5.archives.gov/WH/Accomplishments/eightyears-03.html) have all advocated for a tax system that is "fair", but, have advocated for different tax systems that would produce different outcomes. As a result, it is difficult to know precisely what people are referring to when they reference a "fair" tax system, as perceptions of fairness are subjective.

[3] I avoid the term "loophole." A loophole is "an ambiguity or omission in the text through which the intent of a statute, contract, or obligation may be evaded" (see https://www.merriam-webster.com/dictionary/loophole). Very frequently people speak of loopholes that are simply provisions in the tax code that they do not like, but, which were intended to provide exactly the outcome the provision is observed to provide. As Senator Russell B. Long noted, "[A tax loophole is] something that benefits the other guy. If it benefits you, it is tax reform." The use of the word "loophole", in my opinion, is a clear flag of political rhetoric rather than serious discussion about tax policy, and it obscures what the real flaws in the tax code are. Certainly true loopholes in the tax code exist, but, they are infrequent, and, rarely represent the kind of dollars that provisions intentionally legislated do (in my opinion, a backdoor Roth IRA would be an example of a well-known true tax loophole).

tax system less stable. Taxing book income and the wealth tax are two examples of two such inadvisable taxes.

Perceived Unfairness in the Corporate Tax System

There are widespread perceptions that corporations do not pay their "fair share" of tax, and there are current proposals to increase corporate tax revenue in order to expand government programs and services.[4] If Congress seeks to raise more revenue from corporations, it has the option to either raise the corporate tax rate, expand the corporate tax base, or do both.

Increasing the corporate tax rate is legislatively and administratively simple—firms would multiply their current tax base by a higher rate, and remit more tax. The distortions caused by the corporate tax would increase as the rate is increased, and because that higher tax is borne by consumers, capital owners, and/or employees, individuals will be affected by the increased corporate tax rate. However, no additional regulations, administrative procedure, etc., would be required. Raising the corporate tax rate is a trade-off between balancing the generation of additional revenue and the well-known economic distortions associated with taxation. And while it certainly has fairness implications, I believe most concerns over fairness relate to misperceptions about the tax base.

When I hear concerns that corporations are not paying their "fair share" of taxes, many relate to the tax base. That is, to some it feels unfair to see a company that is perceived to be "big", "successful", or "profitable" not paying what one views as enough in taxes. These perceptions are frequently spurred by political rhetoric, because on their own, very few people spend much time pondering the size of corporate tax payments (Asay, Hoopes, Thornock, and Wilde 2021).

Perceived Unfairness Caused by Misperceptions about Financial and Tax Accounting

Much of the perception about corporate tax fairness follows from the fact that corporations compute profits in more than one way. One way in which corporations compute profits is according to the rules of the Internal Revenue Code. Congress creates these rules with at least three different goals: 1) raise revenue, 2) change taxpayer behavior, for example by incentivizing activities such as the R&D tax credit and the immediate expensing of investments in capital assets, and 3) redistribute income. Another way in which corporations compute profits is according to Generally Accepted Accounting Principles (GAAP). These rules, created by the Financial Accounting Standards Board (FASB), lay out rules for calculating income, the purpose of which is to inform stakeholders, such as investors, about the firm. The FASB is not concerned with collecting revenue, and, if firms change their behavior because of specific accounting rules, to some extent, the FASB considers it a failure—the FASB seeks only to accurately measure income produced by firms (Belnap, Dyreng, and Hoopes 2019).

[4] See https://www.pewresearch.org/politics/2017/04/14/top-frustrations-with-tax-system-sense-that-corporations-wealthy-dont-pay-fair-share/ for evidence on perceptions of tax fairness from 2017. Since then, the statutory corporate tax rate was reduced.

This mismatch between financial accounting income and taxable income frequently leads to allegations of "unfairness." In my view, focusing on the gap between taxable and book income belies a fundamental misunderstanding of the purpose of the two different accounting systems. Expecting a firm to be profitable under the U.S. tax code because it is profitable under U.S. GAAP is akin to asking two different artists to draw the same picture, but give them different sized paintbrushes and different color paints, and expecting the pictures to look the same. Further, the reasons many U.S. firms can show profits under GAAP but remit no tax are well-known, well-understood, and, often created explicitly by Congress.[5] Surely some companies engage in aggressive, sometimes even illegal, tax practices, but the estimates we have available to us suggest that the revenue loss from illegal practices is not as large as from tax expenditures and other legal allowances of the tax code. Further, these allowances are not secrets. U.S. firms above a certain size have to file a Schedule M-3 with the Internal Revenue Service which outlines the differences in taxable income calculated under the tax code and financial accounting income (Mills and Plesko 2003).[6] The aggregate values of these differences are disclosed by the Internal Revenue Service. Below, I describe some of the biggest differences. I use data from the 2017 Statistics of Income Line Counts, as these are the most recent data available from the IRS.[7]

The M-3 lists many different items of revenue and expense (deductions) that are different for tax and financial accounting purposes. The largest difference is depreciation. U.S. corporations claimed $470 billion of depreciation expense according to their income statements (after adjusting for consolidation difference between book and tax accounting, which is also outlined on the M-3).[8] However, due to rules for depreciation deductions (cost recovery) set by Congress, U.S. firms claimed $617 billion in depreciation deductions on their tax returns, a $147 billion difference. Over time, including with the Tax Cuts and Jobs Act, Congress has made the rules for tax depreciation more and more generous, allowing for faster and faster depreciation. This was an intentional act of Congress, aimed at increasing investment among U.S. firms. Research suggests that more generous depreciation increases investment, especially for smaller firms (e.g., House and Shapiro 2008; Zwick and Mahon 2017).

[5] Interestingly, Amazon, a specific case which has drawn much attention, especially in 2018, and was one motivation for the Real Corporate Profits Tax (see https://elizabethwarren.com/plans/real-corporate-profits), reported much less in federal tax than one might expect from their accounting income as a result of flawed financial accounting rules, rules flawed as a result of political pressure being put on the FASB (Zeff 2005). Such political pressure on the FASB would likely intensify if we were to tax book income. For details, see https://tax.unc.edu/index.php/news-media/why-didnt-amazon-pay-any-taxes-despite-having-huge-profits/.

[6] Further, public firms in the U.S. must publically disclose the difference between 21% of their pretax income calculated according to U.S. GAAP, and, their actual GAAP effective tax rate, which also allows insights into why public firms can sometimes remit less than their financial accounting income would suggest.

[7] These values will certainly change as a result of the tax reform of 2017, but, the message I am trying to convey with these values remains the same. These data can be found here: https://www.irs.gov/pub/irs-pdf/p5108.pdf.

[8] While accelerated depreciation is allowed in many other countries for some types of assets, the U.S. is somewhat more generous than other nations with regards with its depreciation rules. See https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/guides/ey-worldwide-capital-and-fixed-assets-26-aug-2020.pdf?download.
Recognizing the incentives it creates, several nations have enacted more generous depreciation rules in response to the COVID-19 pandemic, at least with regards to some types of assets.

After generating a preliminary computation of taxable income by offsetting receipts against deductions, firms include the effects of any net operating losses. U.S. tax law gives the ability to offset tax losses against the income of other periods.[9] This allowance recognizes that only profits are taxed, and, allowing firms to use tax losses from other years recognizes that a one year accounting period is an arbitrary feature of our tax code. Research suggests that the use of NOLs does encourage corporate investment in risky investments, which is important for economic growth (Langenmayr and Lester 2017). In 2017, firms used a total of $155 billion in net operating losses to reduce their taxable income before NOLs.

After subtracting net operating losses, businesses multiply this tax base by the corporate statutory tax rate. After arriving at this preliminary tax amount, firms subtract tax credits. One such example is the R&D tax credit, which provides incentives for companies to engage in research and experimentation. Academic studies suggests the credit is effective in spurring additional research by decreasing the after-tax cost of doing such research (e.g., Bloom, Griffith, and Van Reenen 2002; Rao 2016).[10] This credit was intentionally enacted into law by Congress to change corporate behavior.[11] In 2017, $12 billion of R&D credit were claimed by U.S. firms. The sum of all general business tax credits in 2017 was $32 billion. As these are credits that reduce taxes on a dollar by dollar basis, at a 35% tax rate (which was the rate in the year these data are from), that is equivalent to a 32/0.35= $91 billion tax deduction.

Of the $388 billion in corporate taxes reported on Form 1120 in 2017, just these three items, NOLs, depreciation deductions, and general business credits, account for the equivalent of $394 billion in tax deductions, creating $138 billion in lost revenue in 2017. This lost revenue is the result of explicit allowances in the Internal Revenue Code made by Congress.

The differences between book and taxable income discussed above are all legal and simple applications of U.S. tax law, as passed and intended by Congress. To my knowledge, there is no widespread demand for the repeal of these measures. Yet, they create the large gap that some decry as "unfair". However, some firms certainly engage in tax planning solely with the purpose of reducing their taxable income. Most of this planning is plausibly legal by large, public corporations, but, may not be what Congress intended when they passed the tax law. And, certainly, some corporate tax planning ultimately is determined to be illegal tax evasion. Many of these planning strategies involve shifting income to foreign jurisdictions. Most estimates of income shifting come from before the 2017 regime shift. One estimate suggests that the U.S. loses 4-8%

[9] The use of losses from one period to offset income in another period is extremely common in other countries (Bethmann, Jacob, and Müller 2017), as well as U.S. states (Ljungqvist, Zhang, and Zuo 2017). Many countries, including the U.S., made these rules more generous in response to the COVID-19 pandemic (Gallemore, Hollander, and Jacob 2020).

[10] R&D tax credits are common worldwide. See https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/guides/ey-2020-randd-book-lowres-24-sept-2020.pdf?download. R&D credits are also common across U.S. states (Wilson 2009).

[11] Incidentally, the R&D tax credit was enacted more than a dozen different times, as this is one law that Congress historically only maintained on a temporary basis, historically contributing to tax policy uncertainty (Hoopes 2018). The R&D credit has been made permanent, but many other corporate tax laws are temporary. I know of no reasonable economic rationale for these provisions being temporary.

of corporate tax revenues from income shifting (Blouin and Robinson 2021). In 2017, corporate tax revenue was $388 billion, suggesting $16-31 billion in revenue was not collected.[12,13] Even the most extreme of estimates of profit shifting pin 2017 estimates of profit shifting at $100 billion, still less than the three tax provisions I mention (Clausing 2020a). To be clear, amending the tax code and stronger enforcement of the tax code may help stem profit shifting to some extent, but, that is simply not where most revenue is lost.

Note that these estimates are generated from before the 2017 tax reform change, before what Clausing (2020b) calls "adjustment to the legislation".[14] The primary motivation for international tax planning is facing a high tax rate, and prior to 2017 the U.S. statutory corporate tax rate was one of the highest in the world. Further, the U.S. was one of the only developed countries with a worldwide tax system, which imposed this high tax rate on earnings abroad. Now, with a nominally territorial system and a lower corporate statutory tax rate, companies are reconfiguring their structures, and, determining how to operate in response to the current tax code.[15] Further, the estimates of income shifting I mentioned above were generated before the OECD had fully implemented its BEPS project, which may also have curtailed some profit shifting. It is too early to know the TCJA's net effect on aggregate profit shifting until more time lapses (although estimates that included 2020 data would be useful, but, to my knowledge, do not exist). As such, these estimates from before 2017 are not fully informative regarding the size of the problem now. However, even if tax-motivated income shifting by U.S. multinationals is as large a problem as it was before the TCJA, the estimates of income shifting are smaller, and some significantly smaller, than the figures I previously reported associated with the use of NOLs, tax credits, and accelerated depreciation.

Taxing Book Income

Owing to the perception that corporations don't pay a "fair" amount of tax after arriving at taxable income according to the tax code and financial earnings according to U.S. GAAP, one solution to ensure that this perceived unfairness does not persist would be to fix whatever perceived flaws there are in the tax code so that firms pay a higher amount in tax. However, recently, rather than directly addressing the problem, several proposals have been floated that would include financial accounting income, in some form, in the corporate tax base—proposals that would tax book

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[12] Consistent with this narrative, recent research highlights more precisely why many seemingly profitable firms pay nothing in tax (van der Geest and Jacob 2020). The paper finds that these "zero-tax firms" account for nearly 15% of listed firms in recent years. However, these firms achieve this outcome not as result of tax planning, but, rather, through NOLs and nontaxable income. International tax planning plays a minor role in the outcomes of these zero-tax firms.

[13] These estimates, although regarding a different underlying construction, are consistent in terms of the order of magnitude of the problem with the IRS's own estimates of the total net tax gap for corporations being $32 billion for the most recent time period covered by the tax gap estimates (see https://www.irs.gov/pub/irs-pdf/p5365.pdf).

[14] There are some estimates for income shifting following 2017, but, many involve numerical simulations, and, none use data from after the tax system actually settled into its new equilibrium.

[15] The lower tax rate should encourage less income shifting, while the territorial tax system may encourage more planning, but, that increase should be checked, at least to some extent, with features like BEAT and GILTI.

income. The intuition asserted by proponents of taxing book income is that corporations are incentivized to report high financial accounting income to shareholders, but a low taxable income to the IRS, such that incorporating financial accounting income directly into the tax base would net the two opposing incentives out. The empirical evidence, however, does not support this. Among other reasons, we should not include financial accounting in the tax base because to do so would distort the financial accounting process and politicize the FASB. Further, it is highly unlikely that it would persist as a permanent feature of the U.S. system, contributing to tax policy uncertainty, as evidenced by the fact it has been tried before as part of the Tax Revenue Act of 1986 but was soon after allowed to expire.

Including financial accounting income in the tax base would distort financial accounting income. For example, when GAAP income was previously included in the tax base, companies made financial accounting choices that altered the communication of financial information and deteriorated the financial information available to investors (Gramlich 1991; Dhaliwal and Wang 1992; Boynton, Dobbins, and Plesko 1992; Manzon 1992). Recent reevaluation of previous studies of the issue confirm their original findings, and suggests financial accounting income may be even more sensitive to the tax rate than is taxable income, because the accrual estimation process affords more subjectivity to book reporting (Dharmapala 2020). These types of accounting choices lower the quality of financial accounting income, making it harder for investors to really understand what is happening at a firm (Blaylock, Gaertner, and Shevlin 2015; Hanlon, Laplante, and Shevlin 2005).

This discussion of taxing book income is not the first time the U.S. has attempted to include book income in the tax base. The Tax Reform Act of 1986 included a tax that included book income in its base, the Business Untaxed Reported Profits (BURP), and is the setting of some of the previously mentioned research papers. The financial accounting literature is unified in finding that, in response to the BURP, firms managed earnings to lower financial accounting income.[16] This short-lived provision altered firm's financial accounting choices. There is reason to believe that if book income was once again included in the tax base, the same results would occur. In fact, it is likely that the manipulations to financial accounting income would be even more severe now, since, unlike in the late 1980s, firms now have a popular and credible alternative method of reporting their success to shareholders, which would reduce the financial accounting costs of lowering book income in response to a tax on book income. This alternative method of reporting income to investors, called pro-forma, non-GAAP, or street earnings, is much more common now that in the late 1980s, and, would be difficult to regulate. Non-GAAP disclosures would provide an alternative method for firms to communicate profits unaffected by the tax on book income, but would damage the comparability and effectiveness of financial reporting, and negatively impact capital markets.

[16] In addition to the academic accounting literature being unified in finding negative effects of taxing book income, academic accountants themselves are also fairly united in opposing taxing book income. In 2019, I did an informal, but anonymous, survey of about 100 accounting academics, and of the 39 that responded, 39 opposed a tax on book income. See https://tax.unc.edu/index.php/news-media/what-do-academic-accountants-think-of-senator-warrens-real-corporate-profits-tax/ for more details.

Further, while the tax on book income has been advertised as simple, its actual implementation would be administratively difficult. Many important nuances would arise that need to sorted out in a costly regulatory process, and, this regulatory process may well make the system much more favorable to firms than at first anticipated.[17] With the BURP, for example, regulatory guidance for implementation of the tax was still actually occurring after the BURP was no longer law.[18]

Finally, while a tax on book income would decrease the value of the financial accounting earnings signal to financial markets, it may also have the side effect of politicizing the Financial Accounting Standards Board (FASB), the creators of U.S. GAAP. The SEC does have official oversight of the FASB, but the FASB has, with a few notable exceptions (Zeff 2005), remained politically neutral. Its independence and political neutrality are key to its status as a highly respected standard setting body throughout the world. If the product of FASB deliberation was included in the tax base and had the ability to alter cash flows for firms, it seems plausible that the decisions of the FASB may be less independent. This would further erode the value of the earnings signal (Hanlon and Shevlin 2005).

Finally, like the BURP, and the corporate AMT generally, I do not think a tax based on book income would persist as a viable tax instrument for long, in large part as a result of the negative outcomes outlined above. While corporations, as everyone else, generally support lighter taxation on themselves, they also value, to an extent that is hard to overstate, certainty with regards to the tax system. Taxes that are passed on the thinnest of partisan margins and lack any semblance of bipartisan support are very likely to be overturned the next time Congressional power changes, as we are currently seeing with the TCJA. Businesses plan investments over very long horizons, and, it is essential to know what the tax system will look like as those investments play out. Regardless of the level of taxation, the constant changing nature of the tax code is an impediment to investment. Congress should do all they can to legislate tax law changes they believe in good faith will persist as law.

We should not include financial accounting in the tax base because of the negative consequences it would cause. The revenue it would generate would likely be smaller than advertised as companies plan around it, and would not come close to compensating for the unintended consequences of such a law. I believe the imposition of such a tax would impose a net economic burden on the country and its citizens.

[17] As You (2017) notes, nearly half of lobbying activity aimed at specific legislation takes place after actual legislation as groups lobby to sway the implementation of the bill.

[18] For a detailed understanding of the tax, it would be important to know the details of the tax proposal, and we simply don't have enough information. For example, how are private firms taxed? If the tax only applies to public firms with GAAP audited financial statements, that would provide incentives for public firms to go private, eliminating the possibility of investing in these firms to average retail investors, while preserving this opportunity for the wealthy, which can invest in private equity. If the law allowed other bases other than GAAP audited pretax income, then the base would be much more manageable, and, the tax less effective. For other examples, see https://tax.unc.edu/index.php/news-media/what-to-do-with-danaos-an-application-of-the-real-corporate-profits-tax/ and https://tax.unc.edu/index.php/news-media/what-to-do-with-disney-an-application-of-the-real-corporate-profits-tax/.

Wealth Taxes

Like with corporations, there is a common perception that wealthy people do not pay their fair share of taxes.[19] And, like with corporations, this outcome is often an outcome of the tax system, not, in large part, because of tax planning in ways not intended by Congress.[20] For example, the tax system in the U.S., and elsewhere, is based on the principle of realization, meaning that taxpayers do not pay taxes on unrealized income. For example, no matter how high a stock's price soars, under current tax law, a taxpayer would not be liable to pay taxes on that gain if she persisted in holding the stock—she is taxed only at the time of sale. This fundamental principle of taxation is responsible for many of the most commonly cited examples of wealthy individuals paying relatively little tax.[21]

When large wealth is observed for individual taxpayers without a concomitant payment of tax, one proposal has been to tax wealth directly.[22] This is, incidentally, analogous to when large book income exists but tax remittances are small, one proposed solution is to tax book income directly. At the federal level, the U.S. does not currently tax the wealth of living taxpayers. Such a system would be a fundamentally new approach to taxation, and, would be very difficult to administer. Estimates for the revenue take for a wealth tax as proposed by Senator Warren in her 2020 presidential bid range near $112 billion per year (Smith, Zidar, and Zwick 2020), before accounting for behavioral response. There are several problems with a wealth tax that, in my opinion, outweigh the revenue generated by such a tax. These concerns primarily rely upon the tax being very costly to administer and enforce.[23] There are also concerns that wealth taxation would

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[19] See https://www.pewresearch.org/politics/2017/04/14/top-frustrations-with-tax-system-sense-that-corporations-wealthy-dont-pay-fair-share/ for evidence from 2017. Since then, the individual tax rate was reduced.

[20] Unlike with corporations, there is likely more outright illegal tax evasion among individuals, although the extent of this evasion is very difficult to measure, and, the most reliable measures we have predate some large shifts in individual tax enforcement (Guyton, Langetieg, Reck, Risch, and Zucman 2021).

[21] For example, if the founder of a large corporation with market cap $1.5 trillion owns 10% of the firm, their basis in the corporation is likely small, and, they may well have $150 billion in unrealized capital gains. As long as the wealthy individual investor does not sell the stock and the corporation does not pay a dividend, no income is generated, and, no taxes are owed at the individual level (the corporation, and therefore, to some extent, its shareholders indirectly, may have paid substantial taxes).

[22] Another alternative would be to simply refine the taxation of the current ways that the very wealthy are able to access cash without actually immediately realizing capital gains, such as variable prepaid forward contracts. However, such limitations on the very wealthy accessing tax-free cash may not have a large impact on tax revenue or perceptions of fairness, as the cash that the very wealthy need to finance consumption can sometimes be a very small fraction of their total wealth. Nevertheless, such options should be considered.

[23] The wealth tax, as proposed, has been described as simple. In practice, these taxes are not simple. For example, Scheuer and Slemrod (2021) note, "all wealth taxes exempt wealth below a certain threshold, which varies considerably across countries. Some wealth taxes do not apply to wealth held in a pension or life insurance account. Some have exemptions or reduced tax rates for the wealth in one's primary residence; more generally, wealth tax rules often differ across real estate and financial assets. There are reduced or deferred wealth taxes for certain business assets—for example, to prevent a situation where a family owned firm would need to be liquidated to satisfy a wealth tax liability. Wealth tax bases often leave out trusts established to pass wealth to later generations. Finally, wealth taxes have not been applied to implicit wealth in the form of an individual's human capital, although this is sometimes hard to disentangle from the value of business partnerships (such as law firms or doctors' practices)."

cause unintended consequences, and, when thought of as income taxes, wealth taxes would be perceived by many as themselves "unfair".

Broad wealth taxes depend on wealthy individuals disclosing and valuing their assets. These valuations are highly subjective, and it would be administratively very costly and time consuming for the IRS to challenge.[24,25] Similar valuations are currently done in the context of the current estate tax, and, are often contentious and costly to challenge.[26] However, unlike the estate tax, where each taxpayer only dies once, such that the estate tax is triggered only once, such valuations would need to be done on an annual basis for the wealth tax.[27] Recent research confirms that the wealthiest individuals are able to hide their wealth in ways that even the most rigorous IRS audits (more rigorous than standard operational audits) simply cannot find, and, confirms that the wealth tax would be ripe for income tax evasion for those willing engage in such activities (Guyton, Langetieg, Reck, Risch, and Zucman 2021). The evadability of this tax would also make its application inequitable, with those holding wealth in forms that are difficult to conceal, and those unwilling to illegally conceal, bearing more of the burden of this tax than those holding other types of assets. In short, the administrative and enforcement costs, compared to the revenue generated make this tax an unattractive option to raise revenue.

There is also some empirical evidence on the effects of wealth taxation with regards to taxpayer mobility. As the U.S. has never really had a wealth tax, this evidence comes from other countries, where the intuitional setting may be very different, so it is hard to know how generalizable these findings are.[28] But, in general, as summarized by Scheuer and Slemrod (2021), "Studies of the European wealth taxes often, but not always, find a substantial behavioral response." The U.S. case may be different because the U.S. is a larger country and potentially harder to flee, but, on the other hand, the dollar values at stake are much, much larger in the U.S. context.

Next, the wealth tax, when thought of as an income tax, would be perceived by many to be unfair. To convert a wealth tax on the total value of ones assets, one need simply divide the wealth tax

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[24] For one example of a particularly difficult to value asset in an estate tax setting, see https://tax.unc.edu/index.php/news-media/dead-birds-and-taxes/.

[25] Some have proposed narrowing the scope of the wealth tax to include only assets that are easy to value. This would erode the base subject to tax, as well as create distortions in asset holdings, and difficult to value assets would become tax favored. For example, this would place a tax on bringing a private firm public, and creating a market price for its equity. This would deprive normal retail investors of the ability to invest in as broad an array of firms, leaving some new firms who chose not to IPO to the purview of wealthy investors able to invest the large sums often required to invest in private equity.

[26] However, in the current estate tax, the valuation for estate tax purposes serves as the basis for the asset to the taxpayer inheriting the asset, and the two valuation incentives are somewhat add odds—potentially rationalizing some valuations. No such incentive would exist with wealth taxes.

[27] A valuation in one year would certainly be informative for the next year, but, taxpayer may intentionally invest in higher-volatility assets that are more difficult to value as a way of avoiding wealth taxation.

[28] There are also papers on income taxes on high-income individuals, but, as I view an income tax as fundamentally different than a wealth tax, I do not find this evidence as particularly relevant. However, this literature does find some mobility effects with regards to high-income taxpayers facing taxes targeting high income taxpayers. See https://tax.unc.edu/index.php/news-media/do-billionaires-move-to-avoid-taxes-what-does-the-evidence-say/ for examples.

rate by the rate of return on the assets being taxed. So, for example, if assets grow at 20%, and the wealth tax rate is 2%, that is equivalent to a 20% annual income tax rate. Alternatively, if asset growth is slow in a year, and, returns are 2%, and the wealth tax is 4% (within the realm of proposed rates in the U.S.), that would be equivalent to a 200% income tax in that year.[29,30]

Many of these considerations have played a role in the historical failure of wealth taxation. Like the tax on book income, wealth taxes have been implemented in the past, and, generally have not persisted. A dozen high-income EU countries have tried wealth taxes, and, this form of taxation persists in very few of these countries (Scheuer and Slemrod 2021). The wealth tax failed to succeed in these countries even when the stakes were relatively low—in EU countries in which wealth taxation existed, never was the tax levied at the level considered in recent proposals in the U.S. (Scheuer and Slemrod 2021).[31]

Finally, the tax would be subject to claims of unconstitutionality. Constitutional scholars have asserted that the wealth tax may be unconstitutional (Jensen 2019; Hemel 2019), or constitutional (Johnsen and Dellinger 2018; Glogower 2020). In my opinion, all the arguments of these scholars really confirm is that there are arguments to be made on both sides of a hotly contested issue, and, if legislated, the wealth tax would end up being tried in court, and would create administrative havoc as the case wound its way through the court system.[32] Further, regardless of whether the law would be struck down in court, like the tax on book income, the law has so little bipartisan support that it seems extremely likely that it would be eliminated legislatively if the courts did not eliminate it.[33] This would contribute to the instability in our tax system.

Conclusion

My message is that most of the ways in which large corporations and wealthy taxpayers remit taxes at a level the general public may perceive to be “unfair” are legal methods intentionally

[29] Some wealth tax systems have capped the wealth tax at measures of disposable income. While this can eliminate the problem of absurd tax rate, it adds complexity to the system, and, generally would lead to the ultra-wealthy being perceived as undertaxed, as the disposable income of a multibillionaire may not be that different than the disposable income of a mere multimillionaire.

[30] In general, these extremely high income tax-equivalent rates would happen in bad economic times, which is the opposite of the pro-cyclical nature of the income tax.

[31] For example, according to Scheuer and Slemrod (2021), the Sanders wealth tax would raise 1.56% of GDP in taxes, and the Warren wealth tax would raise 1.34%. For comparison, the wealth tax in Demark raised 0.06% of GDP, in Iceland 0.48%, and in Switzerland raises 1.08%. For more details on why specific EU countries decided to abandon these taxes, see https://www.oecd.org/publications/the-role-and-design-of-net-wealth-taxes-in-the-oecd-9789264290303-en.htm.

[32] This exact scenario is currently playing itself out in Argentina, which recently passed a wealth tax. See https://news.bloombergtax.com/daily-tax-report-international/wealth-tax-sends-argentinas-rich-to-court-in-last-minute-fight.

[33] In my view, the opinion of Larry Summers on this point is useful: Summers recent noted that spending time on “a proposal that the Supreme Court has better than a 50 percent chance of declaring unconstitutional, that has very little chance of passing through the Congress, whose revenue potential is extraordinarily in doubt…seems to me to potentially sacrifice an immense opportunity.” See https://thehill.com/policy/finance/466851-former-clinton-treasury-secretary-knocks-wealth-tax-very-little-chance-of.

legislated by Congress. The income tax in actuality is very broad. However, Congress has legislated many exceptions to its broad ability to collect taxes. If members of Congress seek to raise additional revenue in order to expand the size and scope of government and combat perceptions of fairness, they should start by examining the many items that are currently labeled as "tax expenditures" by the Treasury.[34] Rather than layer on fundamentally new tax systems, members of Congress should call out specific provisions they believe should be changed, take them to the court of public opinion, and, change those provisions. Plastering over a broken tax code with other fundamentally flawed laws, which have been used previously and failed, is not good tax policy.

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[34] For the list of 2020 tax expenditures, see here: https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2020.pdf.

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