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Proposed Wealth Taxation Threatens Jobs, Savings, and Privacy

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Despite what proponents say, wealth taxation doesn't produce desirable economic effects for society, according to economist Lawrence J. McQuillan of the Center on Entrepreneurial Innovation at the Independent Institute.

There is a renewed effort to impose a wealth tax on Americans. Several bills in Congress would tax and redistribute wealth supposedly to benefit the poor and "ensure the wealthy pay their fair share," in the words of President Joe Biden. The plans hold strong appeal among some politicians who prefer to ignore basic economic realities.

What Is Wealth?

The wealth or net worth of an individual, or a family, is the total value of their assets (such as houses, cars, investments, and cash) minus the total value of their liabilities (such as credit card debt, car loans, student loans, medical bills, and mortgage debt). Wealth is a stock variable measured at a point in time. In contrast, income is a stream of monetary returns on assets received over time, such as wages, interest, and dividends.

A capital gain is an increase in value of a capital asset, such as a stock, bond, or real estate, over and above the original purchase price, measured at a point in time. A capital loss can also occur. A capital gain is "realized" when the appreciated asset is sold and the income received, thus constituting a taxable event. An "unrealized" capital gain, sometimes called a "paper gain" or "paper profit," is an increase in an *unsold* asset's value above the initial purchase price. Unrealized capital gains and losses affect the value of total assets and, thus, the investor's net worth.

Traditionally, in the United States, paper gains and losses have not triggered taxable events because they have not yet been realized or "booked." Some politicians want to change this.

Plans to Tax Wealth

President Biden's federal budget plan includes two primary proposals for taxing wealth. He wants to impose an inheritance tax on unrealized capital gains exceeding $5 million for single-filer estate beneficiaries ($10 million for married filing jointly).

Under current law, if unrealized capital gains are inherited, the basis of the original investment is increased to the current market value; thus, no tax is due from the heir. This "step-up" rule prevents inheritances, often investments in ongoing businesses, from having to be liquidated to pay taxes.

Biden wants to eliminate that protection above the threshold amounts. He also wants to impose a new annual minimum tax rate of 25% on income and unrealized capital gains for taxpayers with net worths exceeding $100 million.

Taxing unrealized capital gains amounts to forcing prepayment of liabilities that have not yet materialized (and may never materialize). Biden's new minimum tax would require calculating, auditing, and enforcing collections for two new tax bases: wealth and unrealized capital gains. It would produce perplexing new administrative complexities and significant new costs. The proposal has been introduced in Congress as the Billionaire Minimum Income Tax Act, which the Biden administration claims would raise $360 billion over 10 years.

Joe Biden is not the first U.S. politician to propose a wealth tax. In 2019, Sen. Elizabeth Warren (D-Mass.) proposed the "Ultra-Millionaire Tax" as part of her presidential bid to challenge incumbent Donald Trump. Warren's plan would impose an annual 2% tax on net worth in excess of $50 million up to $1 billion at which point it would increase to 3%. It was estimated at the time that Warren's wealth tax would raise about $3 trillion in new federal tax revenue over 10 years. Her proposal was introduced in Congress as the Ultra-Millionaire Tax Act in 2021 and again in March 2024, with Sen. Bernie Sanders (I-Vt.) as a cosponsor.

Whether advanced by Biden, Warren, or others, wealth taxation is complex and costly to implement; discourages investment, innovation, and entrepreneurship; undermines

private property and economic growth; and is unconstitutional as typically structured.

Key Facts About Taxes and the Wealthy

If the motive behind wealth taxation in the United States is to "make the rich pay their fair share," then the tax is unnecessary because the wealthy already pay more than their fair share. According to President Biden's own Treasury Department, the "very rich" top 1 percent of income earners pay an average federal tax rate estimated to be as high as 31.5%—not the 8% that Biden often claims using a methodology that produces misleading numbers by treating unrealized gains as if they were taxable. The total federal tax burden on the "ultrarich," defined as the top 0.001 percent, has fluctuated around 40% since 1962. By comparison, middle-class households pay an average of 13%, according to the most recent data from the Congressional Budget Office.

The top 10 percent of income earners pay 61% of all federal taxes and 79% of all federal income taxes. The top 1 percent and 5 percent are paying 46% and 66% of federal income taxes, respectively—the highest share since 1980.

Another common misconception is that the richest people do not earn their wealth, but rather inherit it or acquire it by devious means. In reality, the vast majority of the wealthiest people are self-made entrepreneurs, innovators, and business owners—job creators, in other words.

According to the 2024 "Forbes' 38th Annual World's Billionaires List," 66 percent of billionaires are self-made, meaning "they founded or cofounded their company or established their own fortune, rather than inheriting it." The self-made percentage is remarkably stable over time, typically ranging between 66 percent and 70 percent in recent years. Among entrepreneurs and corporate executives in North America with net worths greater than $30 million, 90 percent and 83 percent, respectively, are self-made according to the World Ultra Wealth Report 2023. In the United States today, measures of wealth inequality, when properly gauged, are within historical norms, not growing wildly as proponents of wealth taxes often claim.

Only about 10 percent of the ultrawealthy inherited all of their wealth. Chris Edwards of the Cato Institute has noted that inherited wealth is a "small and declining share of the largest fortunes. Just 15% or so of the net wealth of the richest 1 percent of Americans is inherited." The *Chicago Booth Review*'s Vanessa Sumo, describing the trend in the United States since 1982, says: "[T]he way to strike it rich these days is through one's own efforts, and increasingly less by inheriting old money." Wealth taxes treat self-created wealth and inherited wealth the same.

Another misconception is that the richest Americans hold their wealth in consumption assets such as yachts or piles of jewelry. Instead, their asset holdings consist overwhelmingly of equity investments in private businesses and publicly traded companies. These investments in active businesses generate jobs, income, and innovative new products that enrich everyone and raise our standard of living. Imposing wealth taxes would, thus, lead to less investment and job creation.

The current drive to tax wealth is also motivated by a fundamental misunderstanding of market processes. Nobel laureate economist William Nordhaus has estimated that innovators capture only 2.2% to 3.7% of the "social surplus" from innovations, measured as the total value to society of innovations above the cost of producing them. In other words, when innovators, entrepreneurs, and investors create new and improved products and processes, the profits they earn above a normal return on investment and risk taking is only about 3% of the value they create for consumers.

In a dynamic market economy, creative entrepreneurs such as Bill Gates and Jeff Bezos get rich while consumers capture the benefits—about $97 of every $100 of new value that innovators create for society. Economist Donald Boudreaux has noted that this is a bargain as "successful innovators...[are] obliged by the forces of market competition to give far more material wealth to others than each kept for himself or herself." Wealthy innovators are worth every penny because they bestow immense and widespread benefits by introducing newer and cheaper products, and the wealth they accumulate in the process reflects the value they have created.

Wealth Taxation Is Bad Public Policy

The world's modern experience with wealth taxes shows them to have been largely ineffective at redistribution.

A 2019 survey of annual wealth taxes in Europe found, "The number of European countries with a Warren-style wealth tax has fallen from 12 in 1990 to just 3 today .... Countries repealed their wealth taxes for a combination of reasons: they raised little revenue, created high administrative costs, and induced an outflow of wealthy individuals and their money." Over time, wealth tax codes became "riddled with exemptions," which led the public to view such taxes as unfair. This is to be expected. Economic professors Jessica Flanigan and Christopher Freiman have noted that raising taxes on the rich often backfires: "The greater the tax burden, the more valuable the tax loophole,

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and thus the stronger the incentive to spend to lobby for that loophole."

European wealth taxes have captured only about 0.2% of GDP in revenues, according to a study. France and other countries actually lost tax revenue, on net. Economist Eric Pichet calculated that the French wealth tax, in effect from 1982 to 2017, cost the government 7 billion euros each year, twice what the tax yielded annually, as it shrank the French economy by 3.5 billion euros annually when people reallocated capital, often abroad, to avoid the tax.

"The fact that it costs more than it yields engenders a paradoxical situation in which all of France's other taxpayers, including its least wealthy citizens, must bear the brunt of its overall tax burden," Pichet said (*id.* at 25).

Wealth Taxation Is Complex and Costly, and It Undermines Privacy

Wealth taxation increases the complexity of the tax code by relying on difficult-to-measure aspects of household financial portfolios to determine tax obligations. The steps required to implement and enforce a wealth tax are extremely costly, which is an important reason why so many governments that adopted wealth taxes later repealed them.

Governments must be able to mark asset values to market, which first requires tracking down the taxable wealth of targeted individuals. The asset mixes of very wealthy individuals and households can be complicated, involving homes, land, vehicles, boats, planes, businesses, farmland, artwork, jewelry, collectibles, stocks, bonds, trusts, pension benefits, cryptocurrency, cash, and other assets.

Establishing title and ownership shares would be daunting tasks even with cooperative participants. Targeted individuals, however, have strong incentives to hide their assets legally and minimize ownership shares to avoid such taxes. Financial assets are highly portable: capital flight is one strategy to frustrate overburdened tax assessors. If lawmakers decide to tax wealth held abroad, tracking wealth becomes even more difficult, if not impossible.

Governments must also establish the original cost bases of the assets, as well as current market values and ownership shares. For assets such as artwork or closely held businesses that are traded in "shallow" markets infrequently, revenue authorities would be forced to engage in guesswork to establish "market values" for many assets. Price discovery in real estate can proceed at a snail's pace, especially during periods of significant market adjustments. Asset valuations are more problematic if required annually, as illustrated by ongoing legal disputes about local property-tax assessments. Even something as simple as choosing a "valuation date" creates complexities and opportunities for strategic behavior.

The Biden administration has anticipated some of those problems, and its "Green Book" offers new complexities purportedly to resolve the problems a wealth tax creates. These include various exemptions, deferrals, differing installment payment periods, interest charges, formulaic rules for valuation of "nontradable" assets, penalties, and requirements regarding security pledges. The rules and formulas are biased to benefit the government.

Wealth taxation would require an army of accountants and revenue bureaucrats, prying into every corner of people's lives every year. Nicole Kaeding of the National Taxpayers Union Foundation concluded that it would be "difficult, if not impossible, to imagine the creation of an administrable and fully functional" net worth tax. As the costs, unfairness, and abuses of privacy increase over time, the cries to end wealth taxation would grow louder, as has already occurred elsewhere.

Wealth Taxes Create Perverse Incentives That Are Antithetical to Prosperity

Wealth is accumulated savings in various forms, some of which is more liquid than others. Wealth finances investment. Taxing wealth, therefore, is self-defeating because it penalizes successful asset accumulation that is needed to grow an economy.

The economy's dynamism — whether gauged by business startups, job creation, or innovation — relies on risk-taking by entrepreneurs and investors. Taxing their wealth, especially unrealized capital gains, would create disincentives to work, save, and invest because it reduces the immediate after-tax returns to risk-taking activities.

Rather than soaking the rich, wealth taxes boomerang to hurt ordinary workers by shrinking the capital stock, which decreases worker productivity and wages. Moreover, giving government the power to tax unrealized capital gains limits the ability of asset owners to borrow against those gains to purchase, for example, more capital equipment.

When people transfer assets abroad or become residents of another country to avoid paying wealth taxes, the domestic economy squanders financial and human capital, and the government loses revenue from the wealth tax and from forgone taxes on capital gains, dividends, and interest, as France discovered.

Whether taxing the unrealized capital gains of financial assets, taxing wealth more broadly, or increasing the tax rate on capital income (another Biden proposal), such taxes penalize the virtuous behaviors of saving and investment,

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entrepreneurial risk-taking, innovation, and wealth accumulation, thus undermining prosperity.

Taxes Threaten Private Property Rights

Taxes are compulsory payments to the state in exchange for nothing in particular. There is no guarantee that any revenue raised from a new wealth tax would be used to "reduce inequality." Taxation, however, always puts private property at risk of forced liquidation for taxpayers who lack enough ready cash to pay their tax bills. A wealth tax would thus create one more tax liability that could result in property liquidations, perhaps even of primary residences or family businesses, to pay a tax debt. Illiquid taxpayers may have to sell assets at discounted prices quickly or face the government putting a lien and tax levy on their property to satisfy a tax obligation. Sadly, individuals never safely own their property under a regime of government taxation.

Governments across the country routinely seize private property, especially homes, because of unpaid taxes. In some cases, government officials have taken homes belonging to families for generations, even leaving people homeless, for tax debts of less than 1% of a property's value. Tax-and-take schemes are antithetical to a free and prosperous society built on the primacy of private property rights among all other natural rights.

A Federal Tax on Unrealized Capital Gains Would Be Unconstitutional

The 16th Amendment to the U.S. Constitution, ratified in 1913, permits Congress "to lay and collect taxes on *income*, from whatever source derived, without apportionment among the several states…" (emphasis added). A tax on unrealized capital gains, then, would be unconstitutional because such gains are not income until asset owners sell the assets, and no plan to tax wealth calls for apportionment.

In the 1920 U.S. Supreme Court case *Eisner v. Macomber*, involving a stockholder who received additional shares as a dividend, a majority held that "neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, or the accumulated profits behind it, as income of the stockholder." The same principle should apply to all capital assets. Economic historian Phillip Magness has commented that President Biden (and others) are trying to impose legislatively a new federal tax system that the Constitution explicitly prohibits.

Conclusion: Wealth Taxation Only Benefits Prying Leviathan

Arguments in favor of taxing wealth are rooted in a collection of falsehoods, misconceptions, and cartoonish depictions of the wealthy. Wealthy people do not have swimming pools filled with cash, like Scrooge McDuck, available to pay tax bills. In reality, most of their wealth is invested in ongoing businesses or charitable organizations. Wealth taxes, therefore, discourage long-term investment since people must have enough cash on hand to satisfy their tax obligations. Because many taxpayers lack sufficient cash reserves, wealth taxes, especially annual ones, would put more private property in peril of liquidation to feed Leviathan's endless appetite for resources.

Wealth taxation, ironically, directly hurts those it purports to benefit. Because when there's less capital and prosperity to go around, those on the economic fringes are the first to lose out.

Accumulating wealth by honorable means should be praised because savings is the lifeblood of a prosperous society. A wave of political sentiment is building, however, to punish wealth accumulation using redistributive tax schemes. These misguided proposals are rooted in falsehoods about the wealthy, who overwhelmingly are self-made, invest their wealth in productive businesses and philanthropic causes, and create more value for society than they acquire. The highest income earners are already paying their "fair share" as they shoulder the heaviest tax burdens. The record is clear.

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