The Daily Dish

How to Tax the Rich

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Eakinomics: How to Tax the Rich

The New York Times sums it up: "One Guaranteed Winner in the Democratic Primary: Plans to Tax the Rich." This isn't the most earthshaking insight. Populism on either the left or the right takes aim at the elites, and the affluent are definitely on that list. But it got me thinking because if the United States is *ever* going to take control of its fiscal destiny, the first step will be to stabilize the federal debt relative to the economy (gross domestic product, or GDP). That will require – as my friends on the right tend to emphasize – rapid economic growth and control of federal spending programs, items my friends on the left have no apparent interest in pursuing. It will also require – as my friends on the left are quick to propose – raising more revenue, an idea that is an anathema to some on the right.

So, there may be revenue increases in our future – either from a populist source or because elitists like me are concerned about crushing the economy and the futures of the next generations. And if there is more revenue, it will likely be raised in a progressive (in the old-fashioned, distributional sense of that word) fashion.

This raises the key question: how do you tax the rich?

Well, *don't* adopt fancy new notions like a Sanders or Warren wealth tax. As the AAF research shows compellingly, the wealth tax is an economic boomerang. It is aimed at the affluent, but it ultimately lands on the working middle class because its inelegant (that's the nicest word I could think of) treatment of capital income destroys productivity and real wage growth. And don't make the similar error of thinking that corporations somehow pay taxes and jack up the corporate rate. That will simply make U.S. workers uncompetitive in the global marketplace – to the detriment of their standard of living.

Instead, the answer is to re-shape the income tax to fit the economic lives of the rich. After all, the facts are overwhelming: this is not your grandfather's income tax. It is a surtax on the rich, with the vast majority of revenue collected from a relative minority of Americans. We want the rich to continue to finance investment in equipment, buildings, training, knowledge, and innovation. So provide an unlimited deduction from income for all saving and investment. (Notice that to get the deduction, you have to report the income. Positive incentives are the cure for the vast avoidance problem.)

But what happens when the principle and capital earnings (interest, dividends, capital gains) come back to the individual? Unless they are reinvested (as above), *everything* gets taxed at the same rate as wage income. No possibility of massaging the tax bill by massaging the way the money comes back.

Tax aficionados will notice that the entire tax system is now a large, unlimited traditional Individual Retirement Account. But notice that because *all* returns are taxed, the tax system captures the return to monopoly, luck, swamp-dwelling lobbying, or whatever. Aficionados will also note that this transforms the income tax into a consumed-income tax. I think that is fine; you should distinguish between the affluent who are simply living large and those that are contributing to the growth of the economy.

There is a final step. A concern is often voiced that the wealthy will just continuously save, taking the deduction each time, and never paying the tax. I think this is wildly overstated; the rich I see seem to have bought a *lot* of stuff. But the right way to deal with that concern is to have a forced realization of everything at death. Even for the rich, death and taxes should be unavoidable!

In the end, this is a plea to remember that how one taxes is more important than how much one taxes. That is especially true when taxing the rich.