The Daily Dish

Plucking the 1-Percent Goose

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Eakinomics: Plucking the 1-Percent Goose

It is not news that progressive candidates are on a campaign (no pun intended) to soak the rich. Senator Elizabeth Warren proposed a 2 percent annual tax on assets over $50 million. Senator Bernie Sanders countered with new estate tax rates up to 77 percent. And Representative Alexandria Ocasio-Cortez garnered media attention calling for a 70 percent tax rate on income over $10 million. But to the average reader, these proposals — and more — are a bewildering mix of estate taxes, inheritance taxes, wealth taxes, and income taxes. How should one think about all these?

The first thing to recognize is that, roughly speaking, the same policy goals can be achieved with each of these taxes. To make matters concrete, suppose that a hypothetical taxpayer — let's call him Doug — inherits $100 million. Over the course of his lifetime, Doug earns another $200 million (the ideas business is lucrative), spends $100 million (at PF Chang's), and earns a cumulative 50 percent return over a 50-year period. As a result, he ends up with total investment earnings of $100 million, which when added to the principal from his inheritance ($100 million) and labor earnings ($100 million) leads to $300 million as the value of his estate.

Now, as noted above, there are a number of ways to pluck this 1-percent goose. One could, for example, levy a 50 percent tax on inheritances. That would yield $50 million. Alternatively, a 25 percent estate tax would raise $75 million, which is the present-value equivalent of the inheritance tax (discounted at the lifetime rate of return). These are equivalent wealth taxes. Or, one could tax the return on investment at a 75 percent rate. This would also raise $75 million at the end of the 50-year window and be the equivalent of the inheritance tax. Finally, one could tax at roughly a 30 percent rate the annual investment earnings each year for the 50 years and raise exactly the same revenue.

So, how does one pick? As has been widely noted, there are all sorts of problems with wealth taxes in practice. Of the two options, however, it makes more sense to tax inheritances than estates. After all, if someone distributes $1 to 100 million people, that is very different than giving $100 million to one person. The estate tax treats them the same, while an inheritance tax would not. Interestingly, nobody is talking about an inheritance tax. Or, one could use a tax on capital earnings. But this would mean taxing dividends, interest and capital gains at equal rates — something at odds with legislative history — and would require a relatively low rate (30 percent) to impose a high lifetime tax (75 percent) on capital earnings. Nobody is talking about that either.

The soak-the-rich argument is in full swing. But it is just as interesting to ask how to tax the 1 percent.