The 13th Tokyo Tax Conference

Taxation of High-Income Individuals

Motohiro Sato

Graduate School of Economics Hitotsubashi University

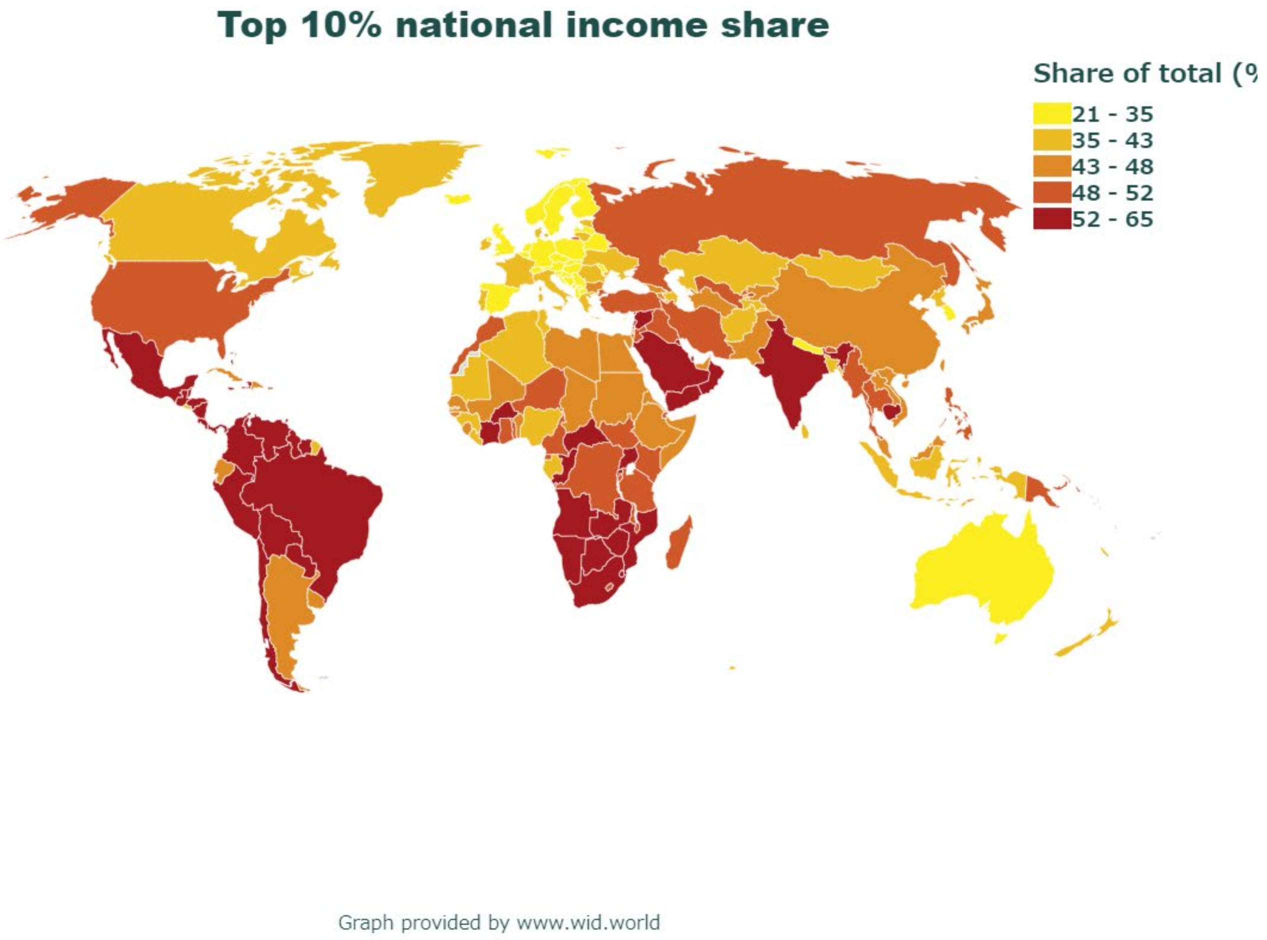
Tokyo

World inequality in 2023

- With economic globalization and digitalization, there has been increasing income and wealth gap around the world.

- There needs to be enhanced income redistribution function raising progressivity of tax system.

- A challenge is to tax the rich whereas not too much disturbing economic growth.

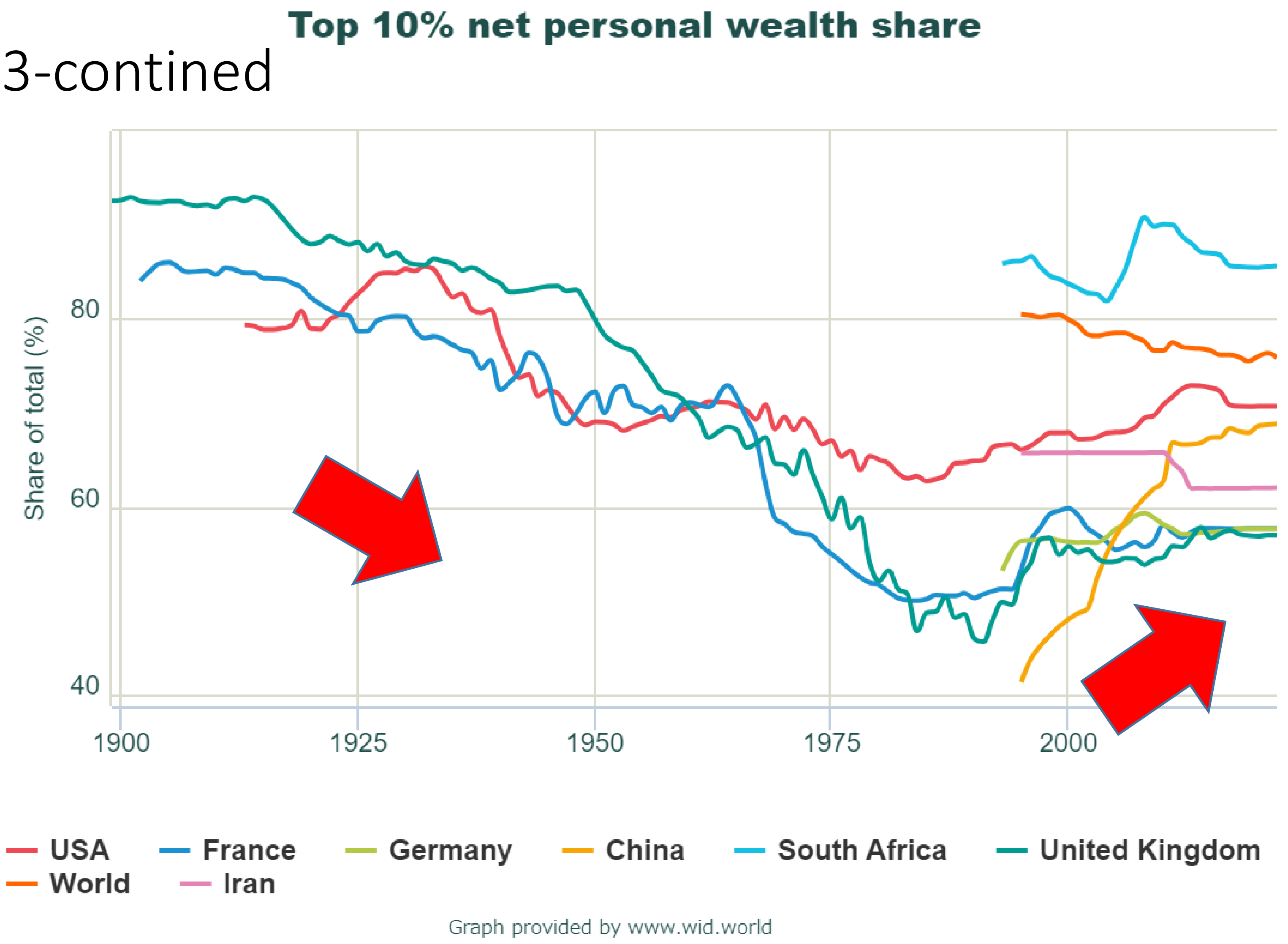


[World - WID - World Inequality Database](https://wid.world)

World inequality in 2023-contined

- Wealth concentration measured by top 10 net personal wealth share declined in 20th century, but has started to increase after the year of 2000.
- r-g gap?

➢ Wealth increase with return on investment (=r), which tends to exceed wage growth corresponding to economic growth rate (=g)



[World - WID - World Inequality Database]

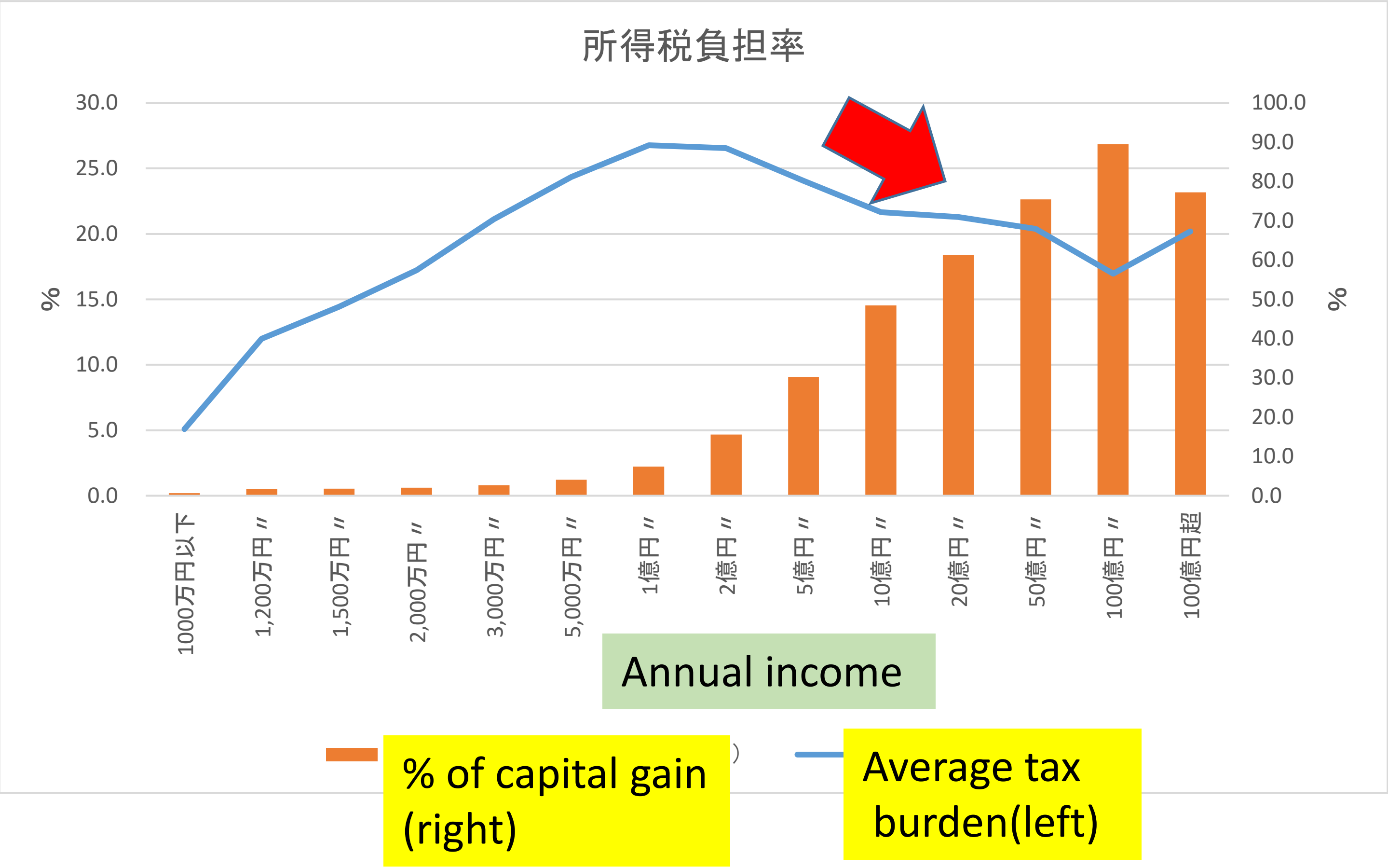
Regressive income tax in Japan?

- Personal income tax payment as a ratio of annual income declines after 10 million yen in Japan.
- This is because

(i) high income earners gain more from capital gain (of stock and fixed assets)

and

(ii) a flat tax rate at 15% (20% including local tax) applies to financial income whereas wage is taxed progressively.

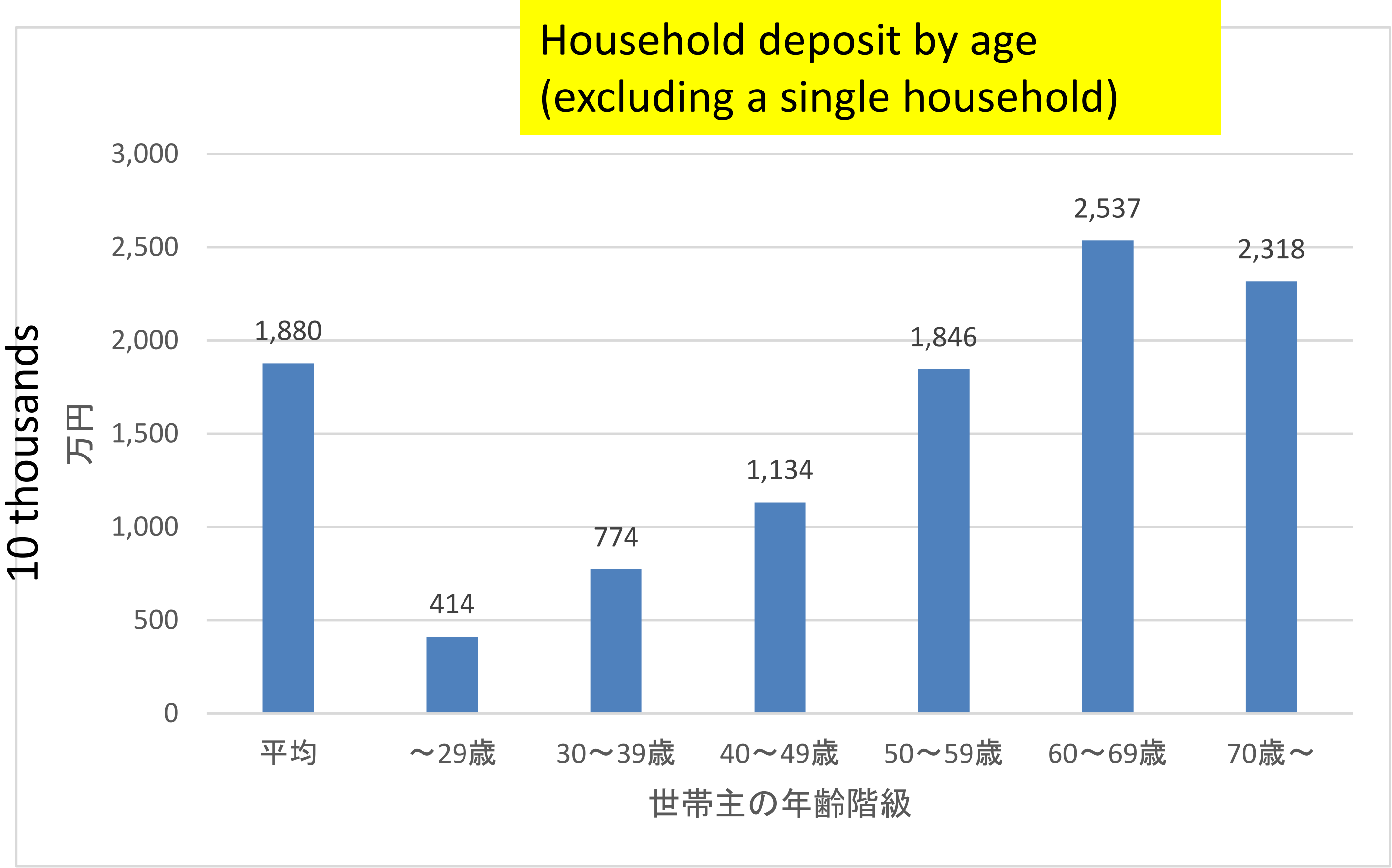


Who is wealthy in Japan?

- Financial asset such as cash and deposits is largely held by the old age household.

✓ On average, their and deposit holding is more than 20 million yen.

✓ It may be hard for the young workers to accumulate financial asset as much since their wage has been staged for decades. (Wage started to increase only recently…)



Source：Household survey（2021）

Here's why this economist says the 'perfect' tax rate for the rich is 75%

CNBC **OCT 15 2019**

- In their new book, economists Gabrial Zucman and Emmanuel Saez say the optimal effective tax rate for the rich in combined taxes — including federal, state, payroll and local — would be 75%.
- Zucman has been advising presidential hopefuls Sen. Elizabeth Warren and Sen. Bernie Sanders on their wealth tax proposals.
- The 75% rate would only apply to the top 1% of Americans, or those who earn more than $500,000 in income in 2019.

Less progressive income tax

- Personal income has become less progressive around the world with top tax rate being lowered.

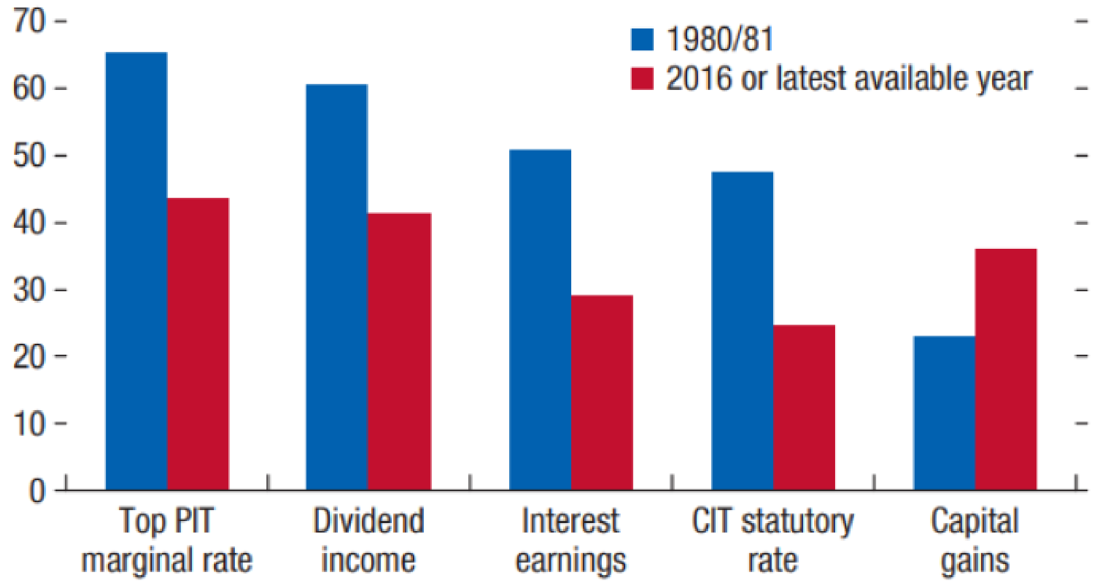
- Progressive income tax leads to tradeoff between efficiency and equity

✓ Efficiency concerns economic growth whereas equity addresses income distribution.

- Lower top tax rate may be to promote growth stimulating labor supply and investment.

- The function of income redistribution has been undermined

Figure 2. Top Income Tax Rates (OECD Averages in Percent)



Shafik Hebous,S., A. Klemm, G.Michielse, and C.Osorio-Buitron, How to Tax Wealth, IMF

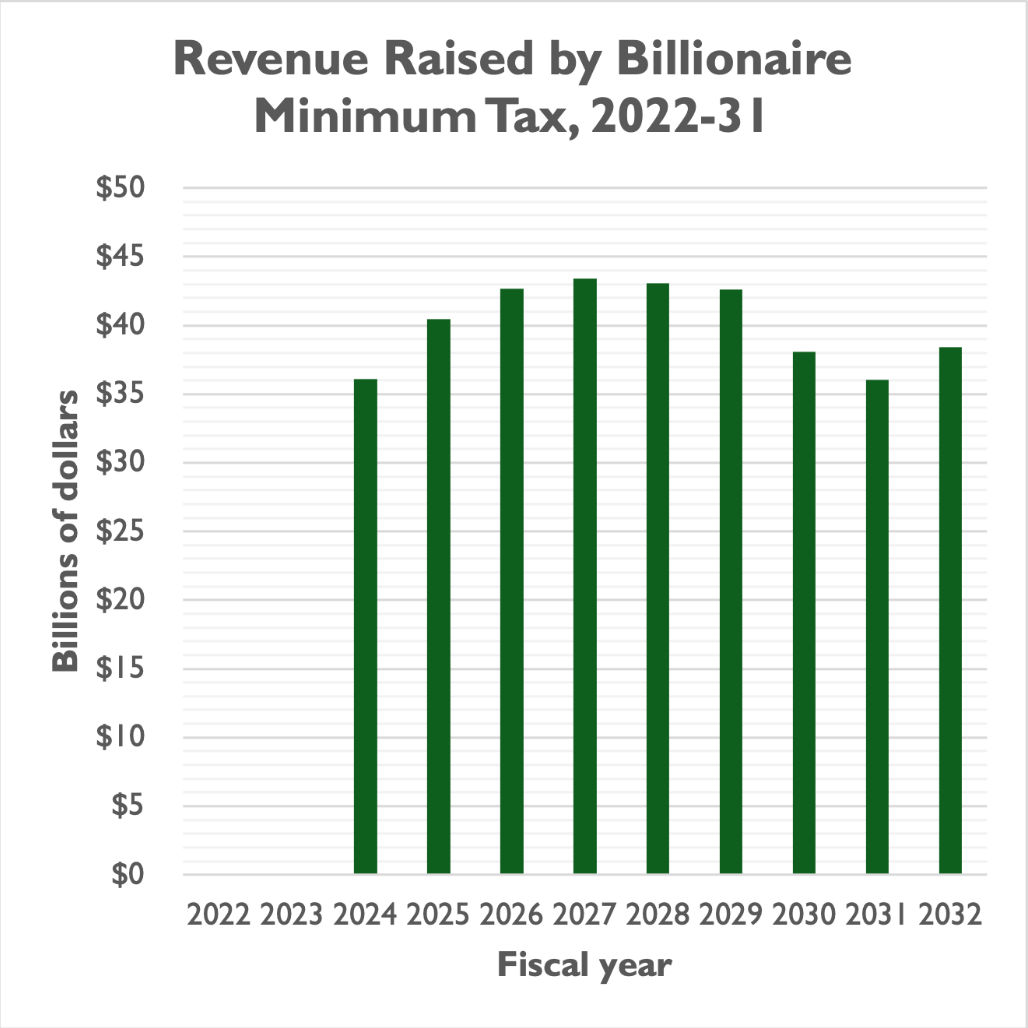
Billionaire Minimum Income Tax Act

- **Billionaire Minimum Income Tax Act** was proposed in 2022

➢ This imposes a minimum tax on individual taxpayers whose net worth for the taxable year exceeds $100 million.

➢ The tax is equal to 20% of the sum of a taxpayer's taxable income, plus net unrealized gains for the taxable year.

✓ The tax may not exceed 40% of the amount by which the taxpayer's net worth exceeds $100 million



[What is President Biden's Billionaire Minimum Tax? - Foundation - National Taxpayers Union (ntu.org)]

Optimal income tax

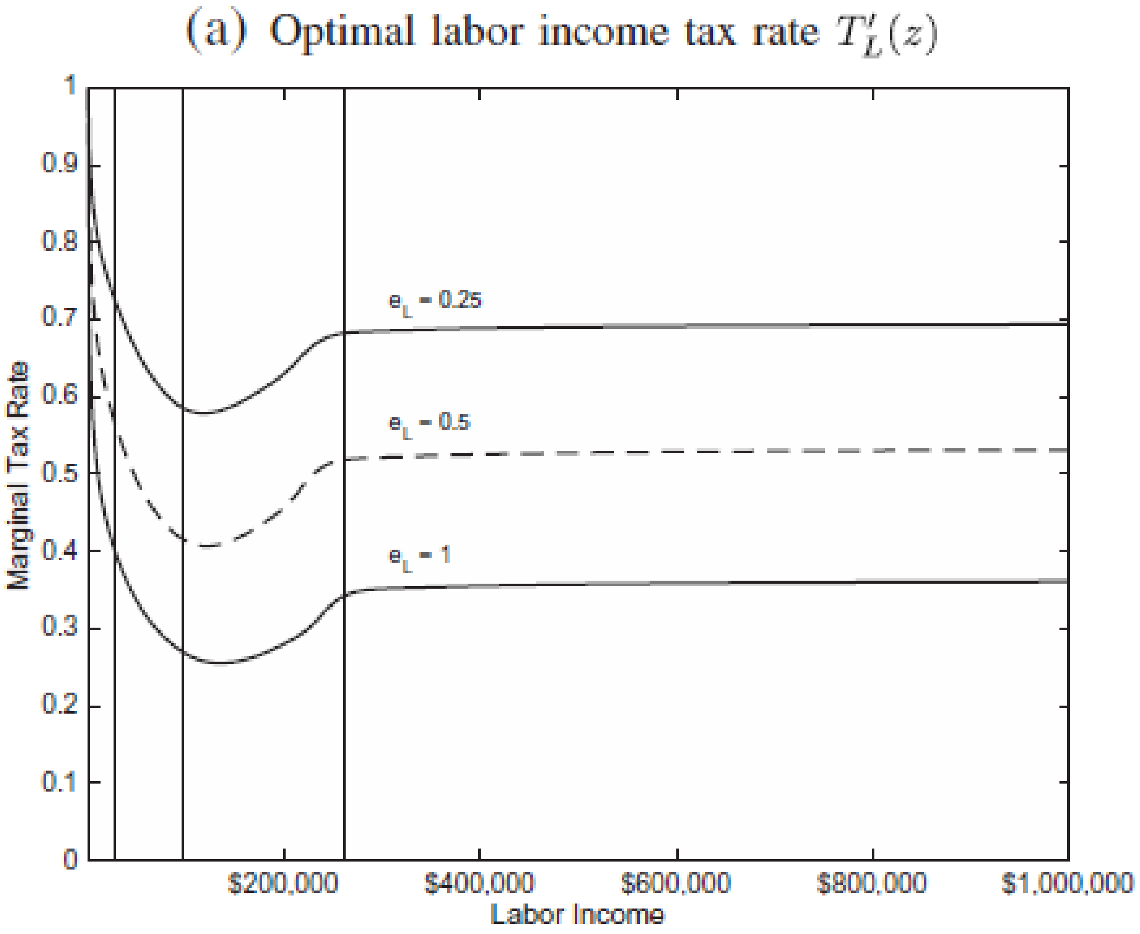
Relative welfare weight

$$g_i = 1/\ ((z_i + rk_i)\ (1 - \tau^{US}) + R^{US})$$

- Optimal income tax is determined to maximize social welfare accounting for behavioral responses to taxation.

➢ Quantitatively, marginal tax rate is calculated balancing efficiency corresponding to elasticity and equity incorporated in relative welfare weights

✓ High elasticity implies lower tax rate



Optimal labor income tax formula

Relative welfare weight on taxpayers with more than z income

$$T_L'(z) = \frac{1 - \bar{G}_L(z)}{1 - \bar{G}_L(z) + \alpha_L(z) \cdot e_L(z)}$$

Elasticity of labor income

Saez,E and S. Stantcheva A simpler theory of optimal capital taxation☆

Capital versus labor income

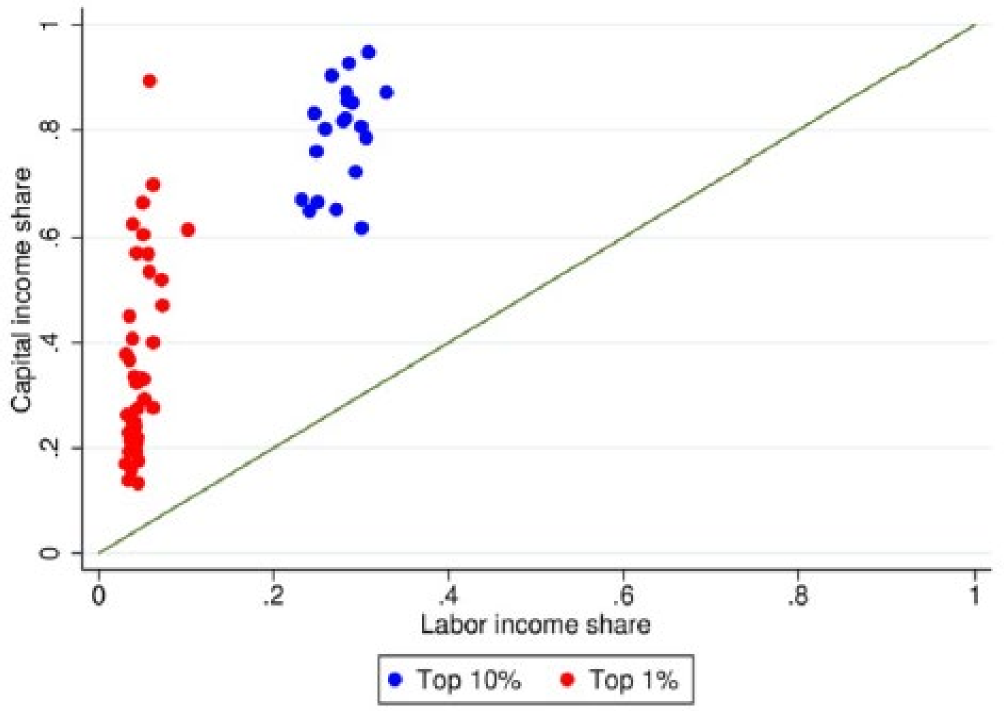
- Capital income is more concentrated than labor income
- Is progressive tax on capital income desirable?

- Atkinson=Stiglitz theorem; if non-linear income tax is being optimized, there is no rationale for taxing capital from equity perspective.

➢ The theorem assumes capital investment is out of labor income and earns only normal return.

➢ What if capital is inherited and if there is excess return?

Figure 3. Capital and Labor Income Shares for Top Incomes, 2018 or Latest



Shafik Hebous,S., A. Klemm, G.Michielse, and C.Osorio-Buitron, How to Tax Wealth, IMF

Option of taxing capital generating income

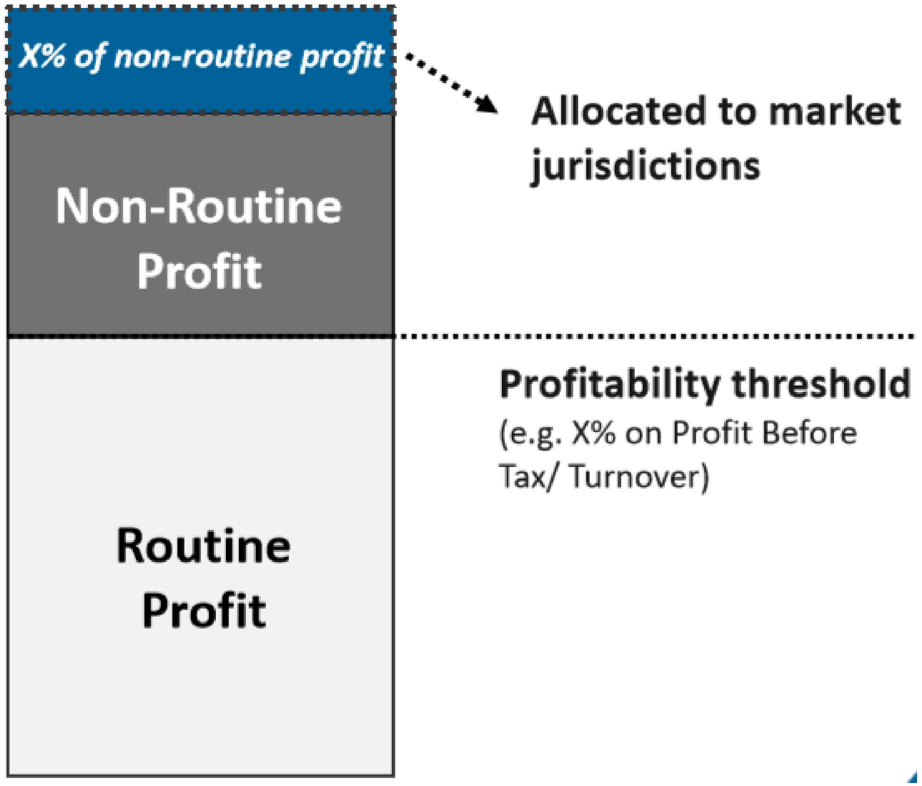
Tax base	Tax	Remark
Flow	Comprehensive income tax	It may fulfil horizontal equity but may undermine efficiency if labor and capital income exhibit different responses to the taxation
	Progressive capital income tax	Progressive tax may exacerbate lock in effect or tax deferral.
	Cash flow tax	It can tax excess return in neutral manner
Stock	Annual wealth tax	There may be administrative difficulty to annually evaluate unrealized capital gain and assets.
	Inheritance and gift tax	Timing of taxing is constrained to when donor is dead
	Estate tax	

Tax on economic rents?

- Lifetime income comprises wage and economic rent with inherited assets.

- Tax on economic rents as well as inherited assets can be enhanced.
- ✓ Rent tax can be achieved by introducing cash flow tax that taxes receipts from investment wheras deducting investment expenses.
- ✓ There has been an international agreement of taxing non-routine profits of large multinational firms by market countries (Pillar one).

OECD Pillar One



Lifetime budget constraint

Present value of lifetime consumption + Estate (Bequest left)

= Present value of Lifetime labor income + Present value of lifetime rent (excess return) + Inheritance (Bequest received) and Gift https://www.tokyofoundation.org/research/detail.php?id=817

Lifetime income tax

Tax liability
in period J

The current value.

$$\bar{z}_{J-1} \equiv \frac{1}{J-1}\sum_{j=1}^{J-1} z_j$$

$$\tau_J = (1+r)^{J-1}\left\{J * T\left(\underbrace{\frac{1}{J}\frac{z_J}{(1+r)^{J-1}} + \frac{J-1}{J}\bar{z}_{J-1}}\right) - (J-1) * T\left(\bar{z}_{J-1}\right)\right\}$$

Present value of lifetime
income from period 1 perspective

Accumulated average
up to period J.

$$\Rightarrow \quad \underbrace{\sum_{J=1}^{J}\frac{\tau_J}{(1+r)^{J-1}}} = J * T\left(\frac{1}{J}\sum_{j=1}^{J}\frac{z_j}{(1+r)^{j-1}}\right)$$

Present value of total tax payment
up to period J from period 1 perspective

Capital income tax versus Wealth tax

	Capital income tax	Wealth tax
Realization versus accrual	Capital income tax is levied on accrual basis and can lead to lock in effect	Wealth tax can be charged on unrealized capital gain.
Normal versus excess return	Capital tax can cover both normal and excess return of capital	Wealth tax is de facto tax on (assumed) normal return.
Administration	Income flow like dividend and interest is easy to observe, while in evaluating capital gain, information on original price is necessary.	Some assets such as unlisted stock are hard to evaluate

Optimal wealth tax

- "Using a simple calibration based on the *Forbes* 400 rich list for the United States since 1982, the long-run elasticity is around 15".
- "The corresponding average wealth tax rate that maximizes wealth tax revenue is given by the standard inverse elasticity rule =**1/ (1 + *e*) = 1/ (1 + 15) = 6.25 per cent**"

Thomas Piketty,T., E. Saez, and G. Zucman(2023) Rethinking capital and wealth taxation

Revenue-maximizing billionaire wealth tax rate

$$\tau^R = \frac{1}{1+e_T}.$$

Table 3. Reported Income Relative to True Income for Top Wealth Holders

	Estates above \$100 million (linked to income tax) (1)	*SCF top .001 percent wealth holders* (2)	*SCF top .01 percent wealth holders* (3)
Year	2007	2016	2016
Wealth (\$ millions)	313	951	365
Reported income (\$ millions)	9.4	30.5	11.6
Reported income/wealth	3.0%	3.2%	3.2%
Average macro return on wealth	5.9%	6.4%	6.4%
Percentage true income reported	**51%**	**50%**	**50%**
Sample size	116	86	465

Saez E. and G.Zucman," Progressive Wealth Taxation"

Wealth tax as supplement of capital income tax

- Wealth tax (on financial assets) may serve as supplement of capital income taxation

- Wealth tax as a minimum tax

➢ A taxpayer may be annually liable to pay higher of either wealth tax or capital income tax

✓ Billionaire Minimum Income Tax in the US may be an example

- Wealth tax as (a sort of) withholding tax

➢ Wealth tax is paid upfront and refunded when capital income tax is paid.

✓ Wealth tax is on accrual basis whereas capital income tax is levied on realization basis.

Challenges

- There has been increasing demand to strengthen taxation on the rich with income and wealth gap being widen around the world.

- There are a couple of questions to be addressed: how to tax the rich? what are economic consequences? What is administrative challenge to implement taxation on the rich?

➢ We may reform the current personal income tax, enhancing progressive taxation on capital income.

➢ We may consider new tax schemes like net wealth tax or tax on economic rents (ideally on lifetime basis).

✓ There should be technical challenges to evaluate financial assets (unrealized capital gain) and calculate excess return on capital.

✓ There needs international tax coordination for taxing the rich like BEPS