The 13th Tokyo Tax Conference
Taxation of High-Income Individuals

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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 inequality in 2023-continued

- 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%

In their new book, economists Gabriel 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

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

• 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

\[ T'_L(z) = \frac{1 - G_L(z)}{1 - G_L(z) + \alpha_L(z) \cdot e_L(z)} \]

Relative welfare weight

\[ g_i = \frac{1}{(z_i + r_k) (1 - \tau^{US}) + R^{US}} \]

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

Elasticity of labor income

Relative welfare weight on taxpayers with more than z income

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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?

### Option of taxing capital generating income

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

- There has been an international agreement of taxing non-routine profits of large multinational firms by market countries (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
Lifetime income tax

$$\tau_j = (1 + r)^{J-1} \left\{ J \cdot T \left( \frac{z_j}{(1 + r)^{J-1}} + \frac{J - 1}{J} \bar{z}_{J-1} \right) - (J - 1) \cdot T(\bar{z}_{J-1}) \right\}$$

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

Accumulated average up to period J.

Tax liability in period J

The current value.

Present value of lifetime income from period 1 perspective

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

https://www.tokyofoundation.org/research/detail.php?id=817
## Capital income tax versus Wealth tax

<table>
<thead>
<tr>
<th></th>
<th>Capital income tax</th>
<th>Wealth tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Realization versus accrual</td>
<td>Capital income tax is levied on accrual basis and can lead to lock in effect</td>
<td>Wealth tax can be charged on unrealized capital gain.</td>
</tr>
<tr>
<td>Normal versus excess return</td>
<td>Capital tax can cover both normal and excess return of capital</td>
<td>Wealth tax is de facto tax on (assumed) normal return.</td>
</tr>
<tr>
<td>Administration</td>
<td>Income flow like dividend and interest is easy to observe, while in evaluating capital gain, information on original price is necessary.</td>
<td>Some assets such as unlisted stock are hard to evaluate</td>
</tr>
</tbody>
</table>
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 $\tau^R = \frac{1}{1 + e_T}$ = $\frac{1}{1 + 15}$ = 6.25 per cent”

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

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

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

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