The Other America: Inequality, Taxes, and the Very Rich

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How The Wealthy Differ from You and Me

Higher economic returns

Lower realized returns

Economic Income > Realized Income for the Rich: Implications

- Understatement of income inequality
- Difficulty inferring wealth concentration from reported income measures
- Overstatement of tax progressivity

Key Findings

- Overall taxes paid during life as percentage of wealth <3% with richest paying smallest fraction
- Long-term real return on assets predominantly held by the very rich (stock) 7-8%
- Only current backstop to extreme wealth accumulation is the estate tax, which was severely curtailed by TCJA (2017)

Theory

Yaari (1965), Feldstein (1995, 1999), many others – People make intertemporal choices in a world of

- uncertain lifetimes
- different statutory tax treatment of different types of income

Persons facing higher marginal tax rates have greater incentive to seek tax-preferred income and to avoid realization

Other influences on type and timing of income:

- medical condition
- demographic traits
- charitable and bequest motives
- homeownership

Data

Original dataset: Decedents from 2007 who filed estate tax return Form 706 (met filing threshold of $2 million in gross estate) (total N=36,889; stratified sample N=12,296)

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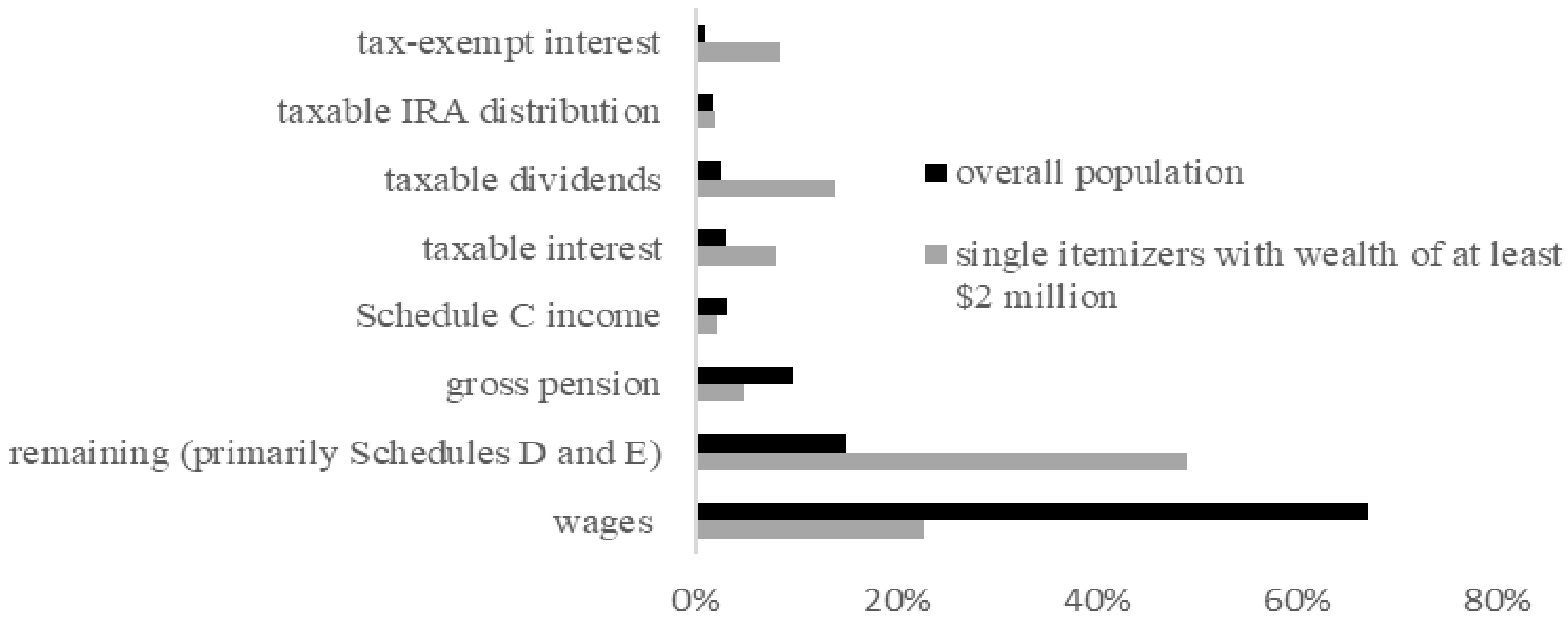
Federal tax returns for 2002-2006 Forms 1040

Analyzed data: Living population in 2007 who had at least $2 million of wealth, itemized on Form 1040, and were long-term single

Data: Single Itemizers, Living Population

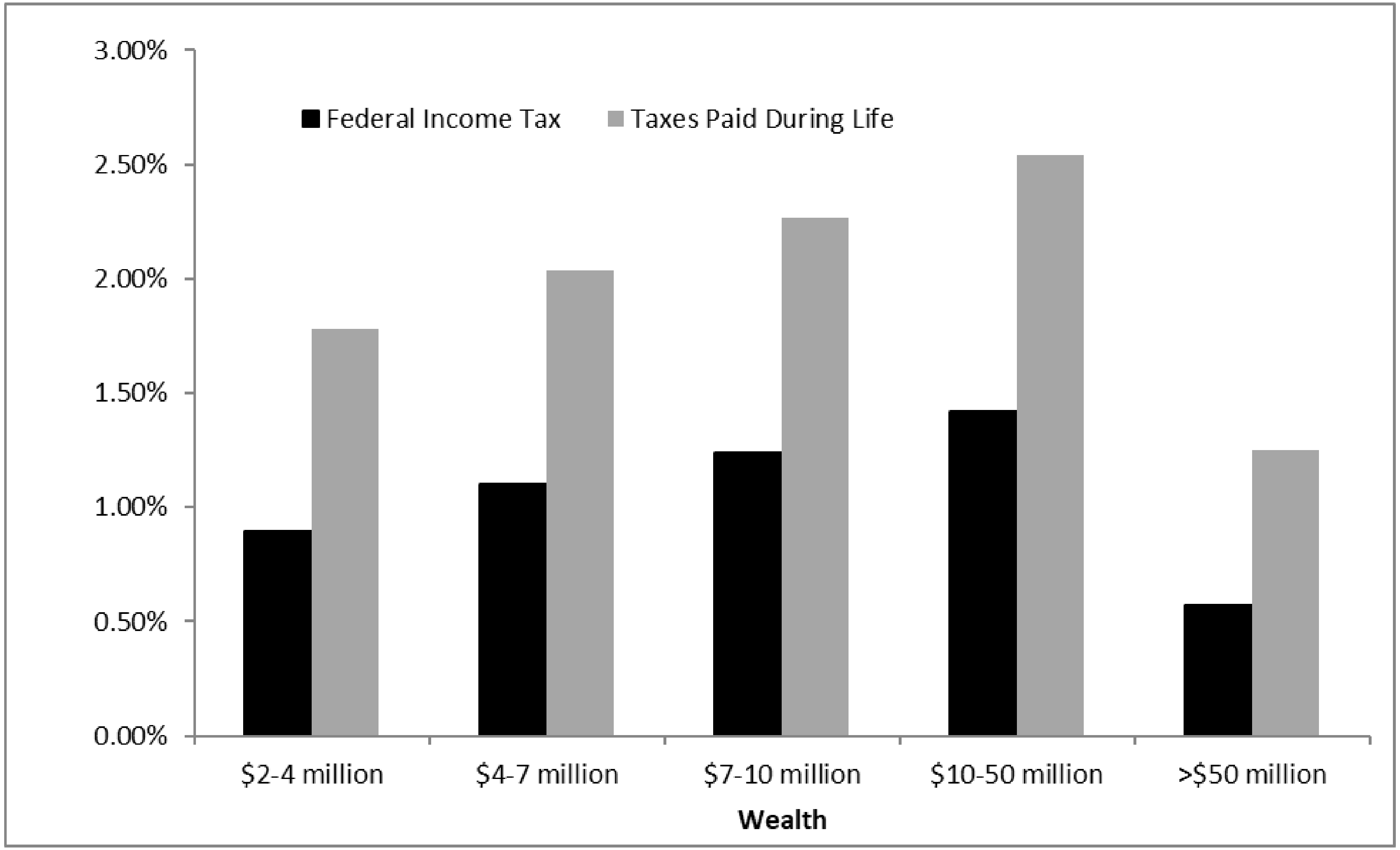
- Use multiplier to estimate living population with assets of at least $2 million
- 92-98% (depending on wealth category) itemized in at least one year between 2002 and 2006 – can obtain information about state and local income tax, real estate tax, other property tax
- Can also calculate Social Security/Medicare tax (assign both parts to employee) and can impute corporate tax via SOI information on overall corporate tax paid
- Focus on single persons to avoid marital deduction issue associated with estate tax and potential Social Security tax issue

Income Elements as Percentages of AGI, 2007

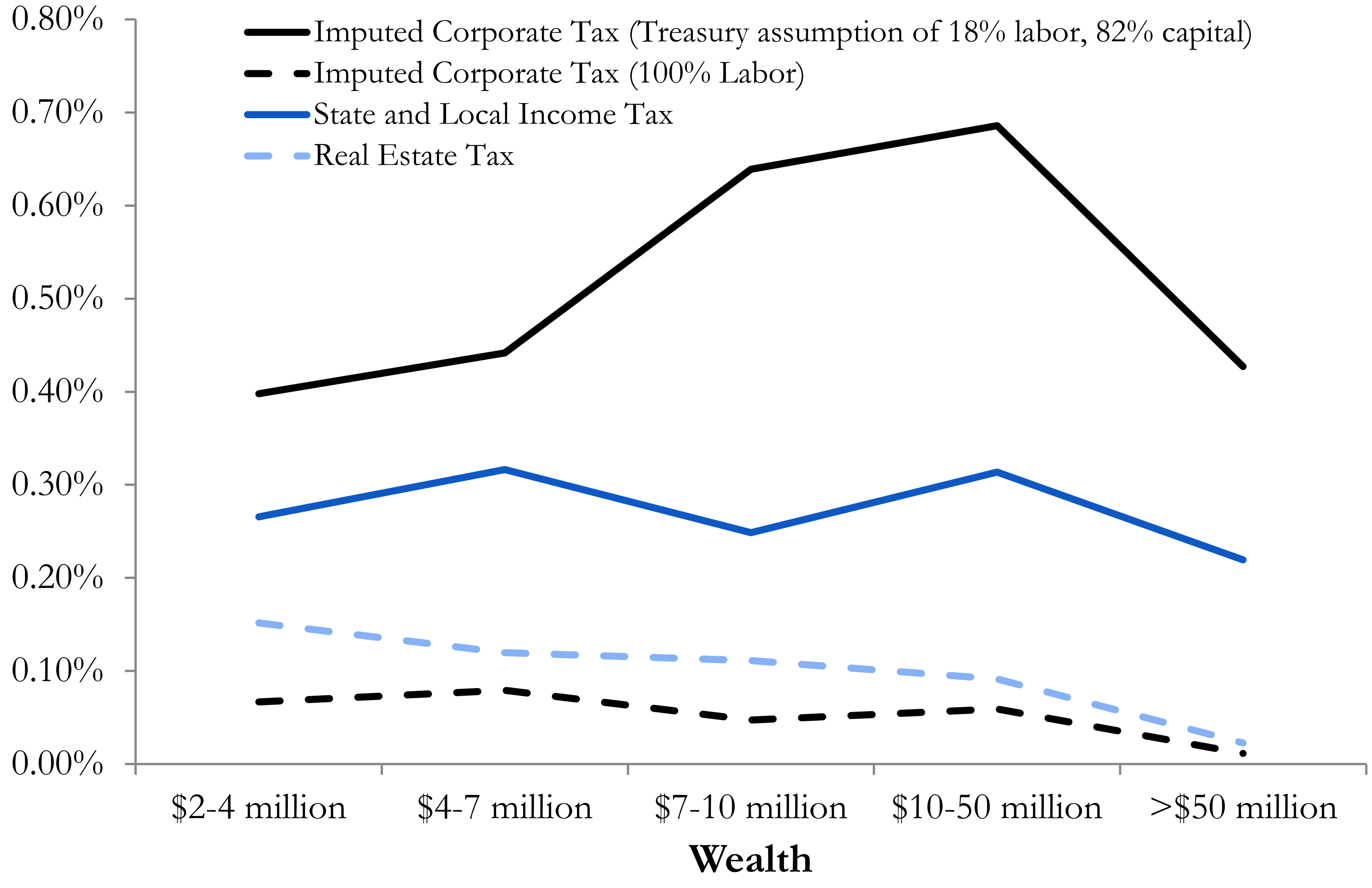


Source: https://www.irs.gov/uac/soi-tax-stats-individual-income-tax-returns-publication-1304-complete report. Schedule C income is income from sole proprietorships, Schedule D income includes capital gains and losses, and Schedule E income includes rents, royalties, and income for S corporations, partnerships, estates, and trusts.

Annual Taxes Paid During Life and Annual Federal Income Tax as Percentages of Wealth, Single Wealthy Itemizers, by Wealth Category



Annual State/Local Income Tax, Real Estate Tax, and Imputed Corporate Tax as Percentages of Wealth, Single Wealthy Itemizers, by Wealth Category



Regression Analysis

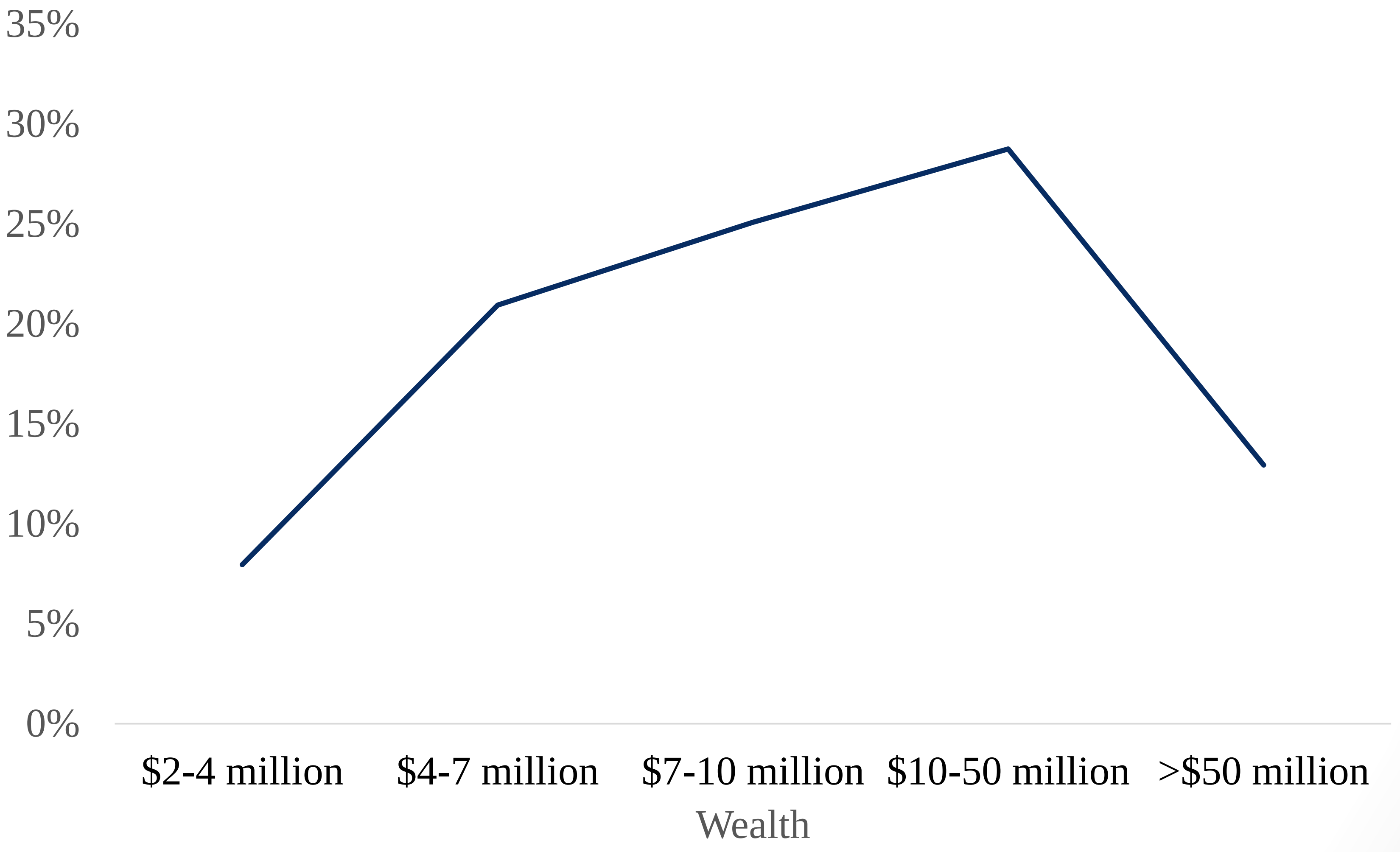
Dependent Variable Ln(taxes paid during life)

Variable	Coefficient	Robust S.E.	Coefficient	Robust S.E.
Intercept	-2.703***	0.667	-2.830***	0.668
Ln(wealth)	0.842***	0.045	0.847***	0.042
Age	0.010	0.013	0.007	0.013
Age squared	-0.0001	0.0001	-0.0001	0.0001
$D_{medical}$[a]	-0.615***	0.065	-0.598***	0.061
D_{male}[b]	0.144**	0.065	0.123**	0.059
D_{beq}[c]	0.012	0.073	0.042	0.075
Homepct[d]	0.224	0.145	0.252	0.133
Ln(charcont)[e]	0.114***	0.013	0.115***	0.012
State fixed effects	no		yes	
N	3952		3952	
Adj. R^2	0.459		0.492	

***significant at the 1 percent level
**significant at the 5 percent level

[a]Dummy variable =1 if individual had extraordinary medical expense (>7.5 percent AGI) in any of the 5 years between 2002 and 2006
[b]Dummy variable =1 if male
[c]Dummy variable =1 if decedent had dependents in 2006, left a trust, or had gift tax payable
[d]Percent wealth held in primary residence
[e]Log of average annual charitable contribution deductions in the period 2002-2006

Federal Estate Tax as a Percentage of Wealth, Single Wealthy Itemizing Decedents, by Wealth Category



The Wisdom of Warren Buffett

- "I still pay a lower tax rate than my secretary"
- Compares capital gains tax rate to rate on labor income
- Doesn't account for discretion in realization

- Wealthy have higher economic returns and lower realized returns than non-wealthy
- Looking only at realized income overstates progressivity of tax system (work in progress)
- Inferring wealth distribution from realized capital income understates wealth inequality (published work)