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Testimony before the Before the United States Senate Committee on the  
Budget

Hearing on “Ending a Rigged Tax Code: The Need to Make the  
Wealthiest People and Largest Corporations Pay Their Fair Share of  
Taxes”

March 25, 2021

Chairman Sanders, Ranking Member Graham, and members of the  
committee:

Thank you for inviting me to testify today on the progressivity of the US  
tax system. It is an honor to participate in this hearing.

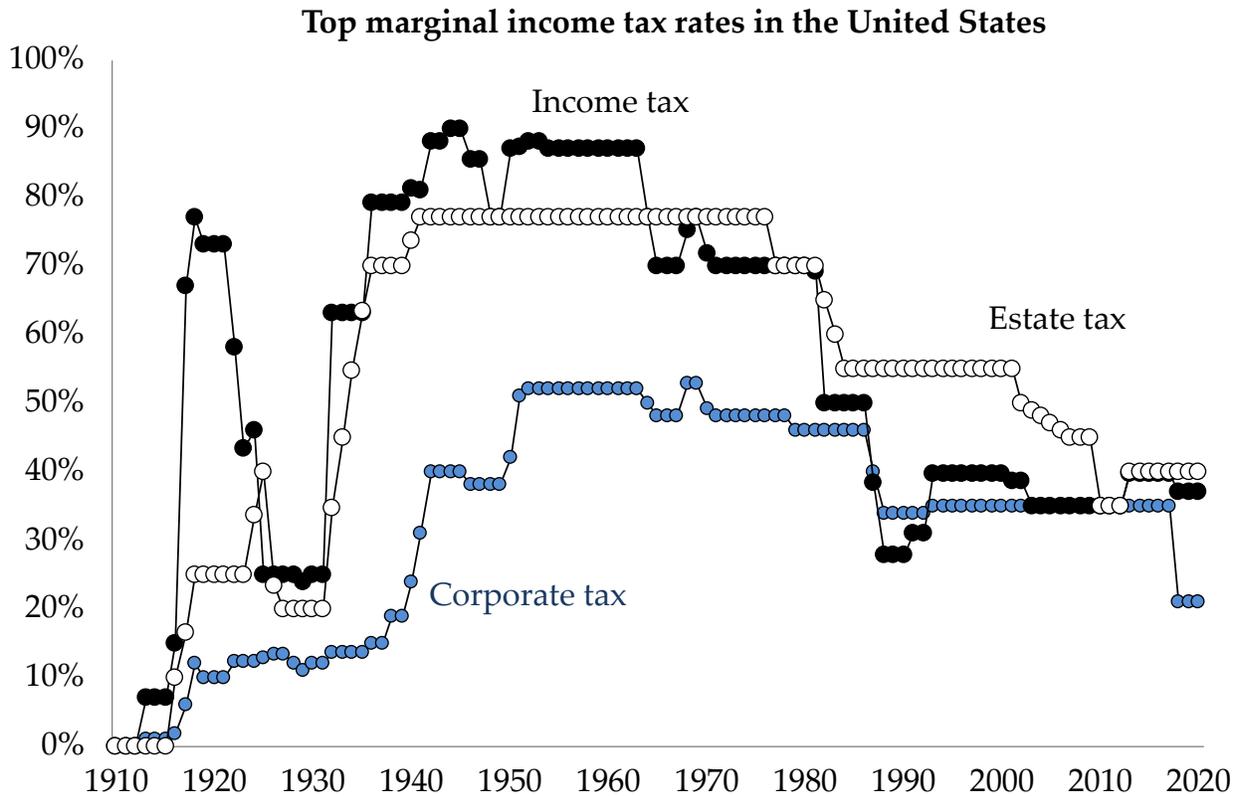
My name is Gabriel Zucman and I am an Associate Professor of  
Economics at the University of California, Berkeley. I am one of the co-  
directors of the World Inequality Database, and I conduct research on  
the interplay between tax policy and inequality.

### **1. The progressive tradition in US fiscal history**

The United States used to have one of the most progressive tax systems  
in the world.

From 1930 to 1980, the top marginal federal income tax rate averaged  
78%. This top rate reached as much as 91% from 1951 to 1963. At the

same time, corporate profits were taxed at 50%. The largest estates were taxed at rates close to 80%.



Source: E. Saez and G. Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, WW Norton, 2019.

No other country, with the exception of the United Kingdom, ever applied such high marginal tax rates on the wealthy.

Some commentators look at this history and dismiss the idea that the United States ever had a progressive tax system. “Nobody paid those 90% tax rate,” they argue. The tax system was no more progressive during the middle of the twentieth century than it is today, according to this view.

Along with my colleague Emmanuel Saez, we investigated these claims thoroughly.<sup>1</sup> We came to two main conclusions.

1. First, it is true that few US taxpayers faced the 90% top marginal income tax rates that prevailed at mid-century. But this was a feature of this policy, not a bug! High top marginal tax rates aimed at reducing inequality, not at collecting revenue. These rates applied to extraordinarily high incomes only, the equivalent of more than several million dollars today. Their goal was to discourage anyone from earning such sky-high incomes in the first place. Their goal, in other words, was to reduce the inequality of *pre-tax* income.

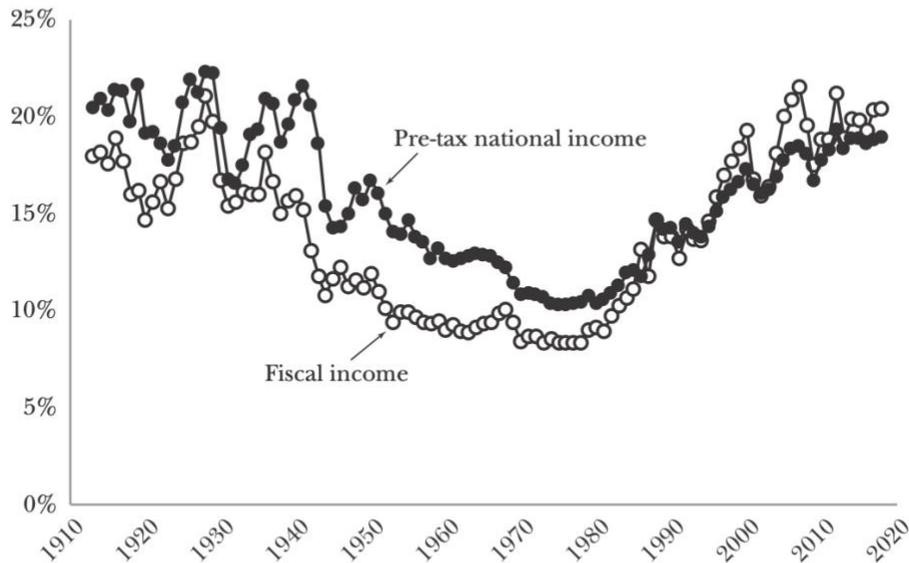
And this policy achieved its goal. From the 1940s to the 1970s, inequality collapsed. According to the best available estimates, the share of America's pre-tax national income earned by the top 0.01% declined from more than 4% on the eve of the Great Depression to 1.3% in 1975, its lowest level ever recorded. The same evolution can be observed for other top groups, such as the top 1%.<sup>2</sup>

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<sup>1</sup> See E. Saez and G. Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, WW Norton, 2019; see also E. Saez and G. Zucman, "The Rise of Income and Wealth Inequality: Evidence from Distributional Macroeconomic Accounts," *Journal of Economic Perspectives*, 2020, 34(4), 3–26.

<sup>2</sup> T. Piketty, E. Saez and G. Zucman, "Distributional National Accounts: Methods and Estimates for the United States," *Quarterly Journal of Economics*, 2018, 133(2), 553–609.

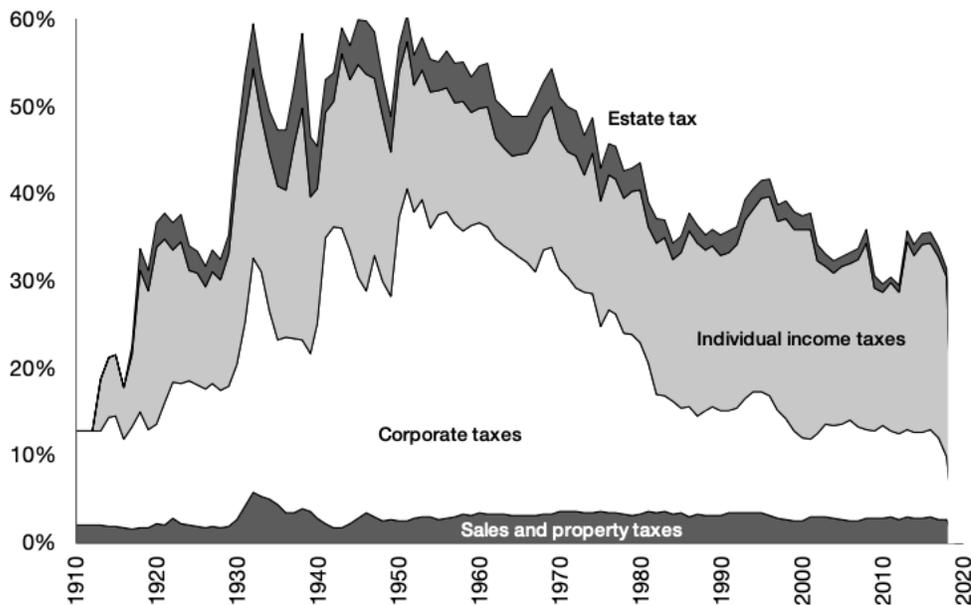
*Figure 3*  
**Share of Income Earned by the Top 1 Percent**



*Note:* This figure compares the share of fiscal income earned by the top 1 percent tax units (from Piketty and Saez 2003, updated series including capital gains in income to compute shares but not to define ranks, to smooth the lumpiness of realized capital gains) to the share of pre-tax national income earned by the top 1 percent equal-split adults (from Piketty, Saez, and Zucman 2018, updated September 2020, available on WID.world).

2. Not only did the wealthy see their incomes constrained, but on their reduced income they paid high effective average tax rates. The average tax rate of the top 0.1% highest earners culminated at 60% in the early 1950s. It remained around 55% during President Eisenhower's two terms.

(Average tax rate of the top 0.1% income earners)



Notes: The figure depicts the average tax rate and its composition by type of tax for the top 0.1% income earners since 1910. All federal, state, and local taxes are included. Corporate taxes include business property taxes (while residential property taxes are lumped with sales taxes). The main driver of the top 0.1% tax rate has been the corporate income tax, which was very large from the 1930s to the mid-1970s and has eroded since then. Complete details at [taxjusticenow.org](http://taxjusticenow.org).

The US tax system achieved a high degree of progressivity through the combination of high corporate taxes, high top marginal income tax rates, and high top estate tax rates.

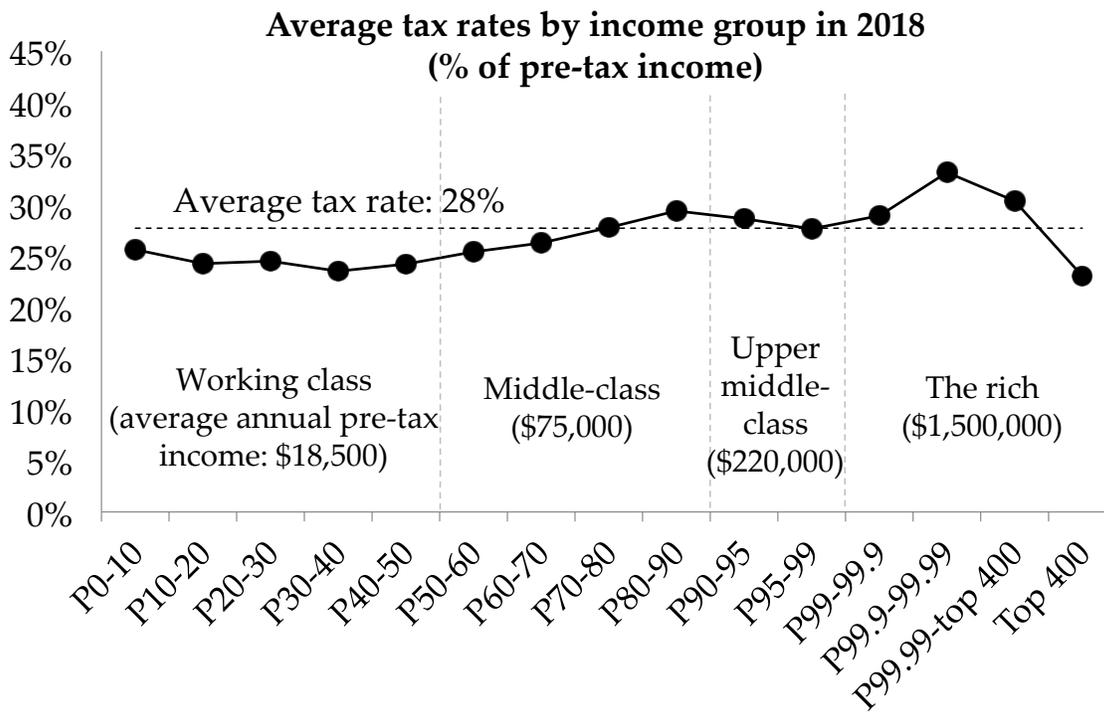
- Corporate profits, the main source of income for the rich, were subject to a high effective corporate tax rate of around 50 percent.
- The very high top marginal individual income tax rates made it impossible for business owners to bypass the corporate tax by using pass-through businesses such as partnerships.
- The wealthy were hit both by the progressive individual income tax on their realized capital income and by a progressive estate tax at the time of death.

The combination of the income tax, the corporate tax, and the estate tax made the tax system extremely progressive and hard to avoid. The US tax system was undeniably progressive in the middle of the 20<sup>th</sup> century—not only on paper, but also in actual facts.

## **2. The lack of progressivity of the current US tax system**

Today, the situation looks quite different. When taking into account all taxes paid at all levels of government, the US tax system is barely progressive anymore. In fact, it looks like a giant flat tax that becomes regressive at the very top end.

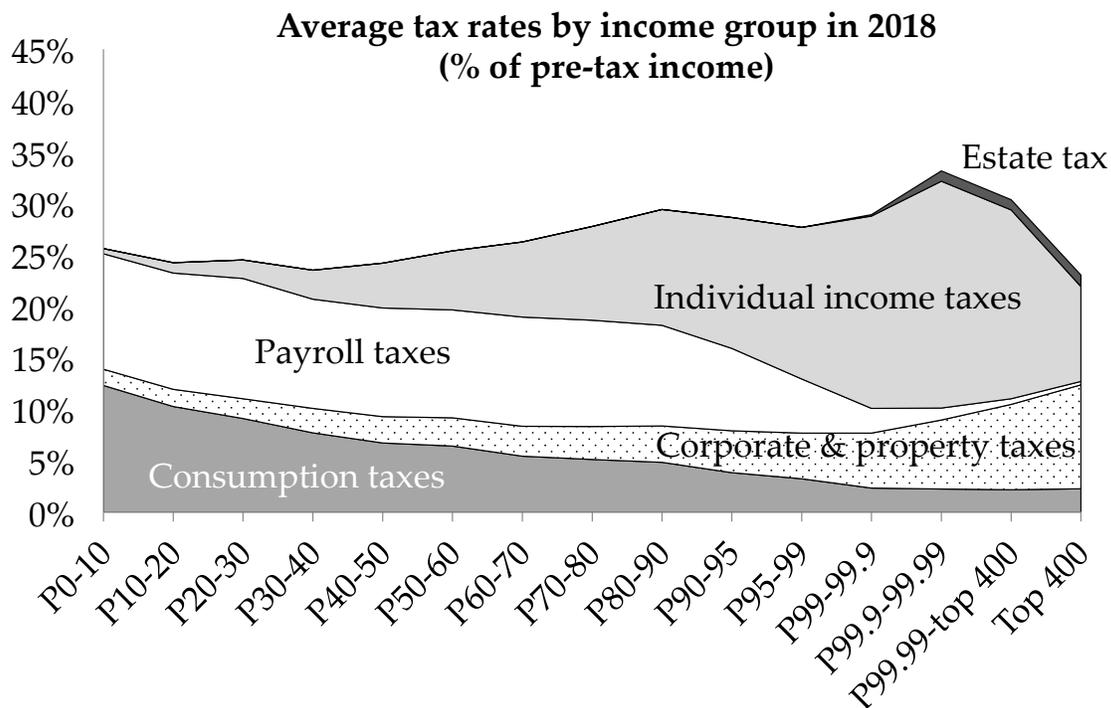
Americans pay on average 28% of their income in taxes: this is official tax to national income ratio of the United States. But now let's compute the average tax rate of the various social groups. The working class—the five bottom deciles of the income distribution—pays around 25% of its income in taxes. The average tax rate then slightly increases for the middle class—the next four deciles—and stabilizes at around 28% for the upper middle class. Taxes rise a bit for the rich but never substantially exceed the average rate of 28%. Finally, they fall to less than 25% for the 400 richest Americans. As a group, and although their individual situations are not all the same, billionaires pay lower average tax rates than middle-class Americans.



Source: E. Saez and G. Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, WW Norton, 2019.

How is this possible?

Working-class Americans pay a significant fraction of their income in payroll taxes and sales taxes. Every worker in the bottom deciles, no matter how small her wage, sees her paycheck immediately reduced by 15.3%: 12.4% for Social Security contributions and 2.9% for Medicare. Consumption taxes absorb more than 10% of income in the bottom deciles compared to barely 1% or 2% at the top, because the poor often consume all their income, while the rich save part of theirs (and the ultra-rich almost all of theirs).



Source: E. Saez and G. Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, WW Norton, 2019.

Billionaires, on the other hand, enjoy two major tax breaks.

First, dividends and capital gains—the two key sources of income for billionaires—are subject to low statutory tax rates: 20% (as opposed to 37% for top wages).

Second—and more importantly—a lot of the income of billionaires is not subject to the personal income tax. To understand why, it is useful to take an example. What’s the true economic income of Mark Zuckerberg? He owns about 20% of Facebook, a company that made \$33 billion in profits in 2018. So his income that year was around 20%

of 33 billion, \$6.6 billion. However, Facebook did not pay any dividend, so none of these \$6.6 billion were subject to individual income taxation.

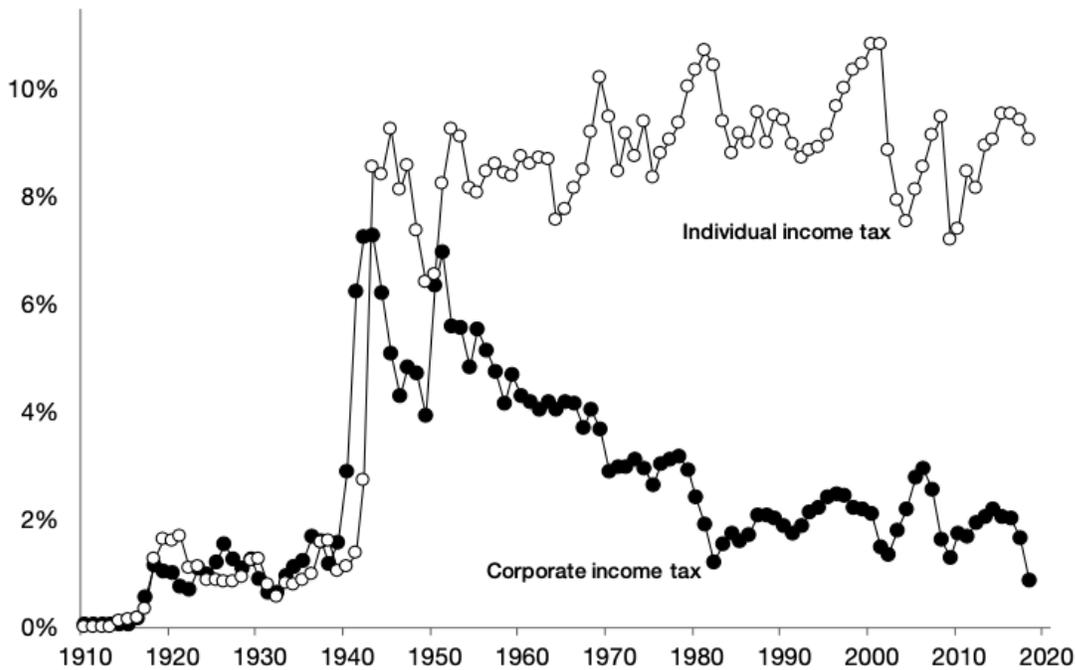
And the CEO of Facebook is not an isolated case: Jeff Bezos, Elon Musk, Larry Page, Sergei Brin, Warren Buffett—altogether, 6 of the 10 wealthiest Americans—are all large shareholders of companies that do not distribute dividends—and thus pay a very low tax rate relative to their true economic income. That’s how middle-class Americans end up paying higher tax rates than billionaires.

### **3. The rise of offshore tax avoidance**

The only sizable tax a number of billionaires pay is the corporate tax they pay through the companies they own. But now a key problem comes into view: the corporate tax has almost disappeared.

In the early 1950s, the federal corporate income tax collected 6% of national income, almost as much as the individual income tax. Today, in the aftermath of the Tax Cuts and Jobs Act, the corporate tax raises only about 1% of US national income. It has been reduced by a factor of 6.

(Federal corporate and individual income tax revenue,  
percentage of national income)



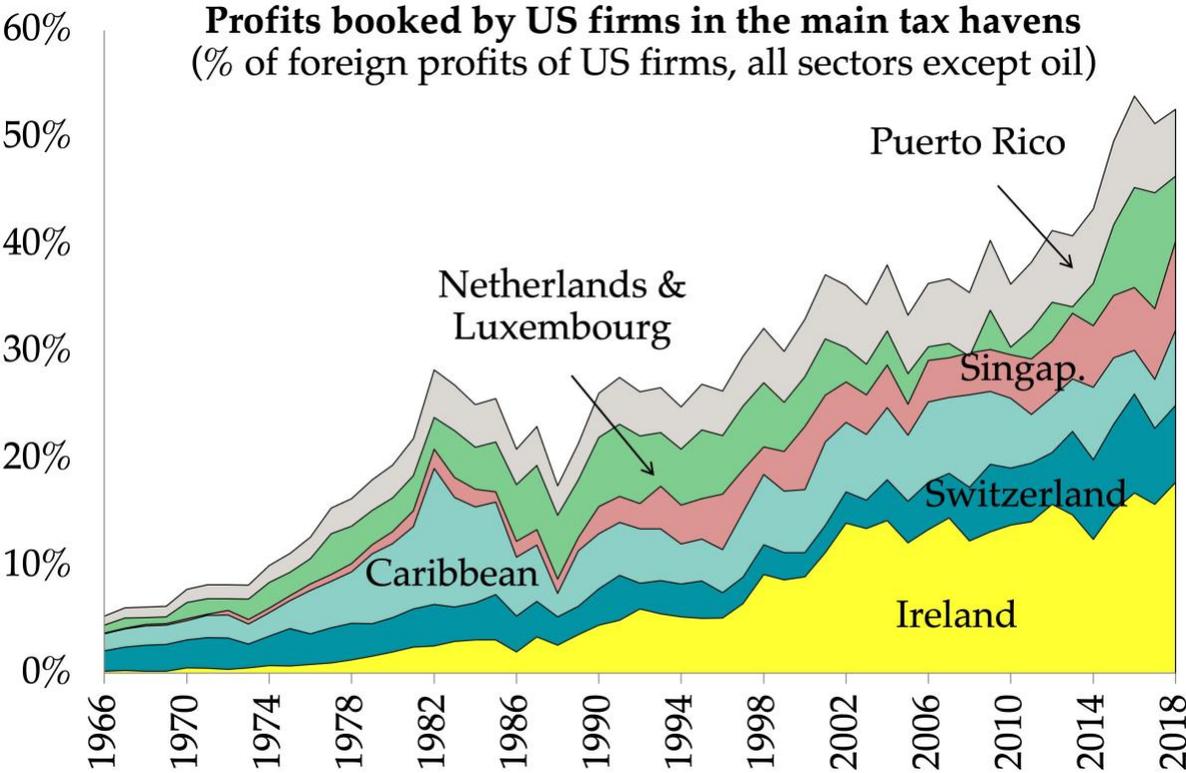
Notes: The figure depicts federal corporate tax revenue and federal individual income tax revenue as a share of national income since 1913. Both the corporate and individual income tax increased sharply during World War II. Individual income tax revenue has stayed about stable (around 10% of national income) after World War II while corporate income tax revenue has eroded. In 2018, federal corporate tax revenue was only about 1% of national income, the lowest since the Great Depression. Complete details at [taxjusticenow.org](http://taxjusticenow.org).

In all capitalist societies, the richest people derive most of their income from shares, the ownership of corporations—the true economic and social power. When corporate profits are taxed stiffly, the affluent are made to contribute to the public coffers. In effect, the corporate tax serves as a minimum tax on the affluent.

Today, low corporate taxes mean the ultra-wealthy, whose income mostly derives from owning shares in corporations, now really can get off almost scot-free.

Part of the decline in corporate tax revenues owes to changes in the statutory rate, most importantly the cut in the corporate tax rate from 35% to 21% in the Tax Cuts and Jobs Act of 2017. But another—and even larger—part of the decline owes to the rise of tax avoidance.

In the post-war decades, company executives did not consider it their duty to avoid taxes and did not have much of a tax-planning budget. Today, many of them do. Moreover, a large industry has developed to corporations avoid taxes, in particular by shifting profits to low-tax countries.



Source T. Wright and G. Zucman (2018), "The Exorbitant Tax Privilege", NBER working paper #24983, series updated to 2018.

More than half of the foreign profits of US companies are booked in tax havens today. In 2018, according to the most recent data of the Bureau of Economic Analysis, US multinationals booked more profits in Bermuda and Ireland alone than in the United Kingdom, Japan, France, Germany, and Mexico combined. U.S. multinationals appear to make a particularly extensive use of tax havens in international perspective.<sup>3</sup>

Wealthy individuals use tax havens too. Globally, about 8% of the world's household financial wealth is held in tax havens.<sup>4</sup> Not all of this wealth evades taxes. There has been important progress over the last decade in fighting offshore wealth evasion, thanks in particular to the Foreign Account Tax Compliance Act and similar laws abroad. However, financial opacity remains extreme. Tax abuse remains rampant, as recent research using leaked data from offshore financial companies (such as the Panama Papers) has documented.<sup>5</sup>

#### **4. Fighting tax evasion in the 21<sup>st</sup> century**

Tax avoidance and tax evasion are not laws of nature; they are policy choices. Following the footsteps of President Roosevelt, U.S. policymakers in the post-war decades chose to fight avoidance and evasion aggressively—by funding the IRS, by regulating the supply of tax-avoidance services, by patiently explaining why taxes “are the price to pay for a civilized society.

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<sup>3</sup> T. Tørsløv, L. Wier and G. Zucman (2020), “The Missing Profits of Nations”, NBER working paper #24701.

<sup>4</sup> See G. Zucman (2013), “The Missing Wealth of Nations: are Europe and the US net Debtors or net Creditors?”, *Quarterly Journal of Economics*, 128(3), 1321-1364. See also G. Zucman, *The Hidden Wealth of Nations: the Scourge of Tax Havens*, University of Chicago Press, 2015, and A. Alstadsæter, N. Johannesen and G. Zucman (2018), “Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality,” *Journal of Public Economics* 162: 89-100.

<sup>5</sup> See for instance A. Alstadsæter, N. Johannesen and G. Zucman (2019), “Tax Evasion and Inequality”, *American Economic Review*, 109(6): 2073-2103

It is possible to re-connect today with this tradition, and to adapt it to the reality of the 21<sup>st</sup> century.

The first step towards a fairer tax system involves increasing IRS budget. Appropriations for the IRS fell by about 20 percent (adjusted for inflation) since 2010. The decline in funding levels resulted in a 31 percent decline in the number of full-time employees working in enforcement roles. The examination rate for individual returns fell by about 45 percent between 2010 and 2019 and for businesses with assets equal to or exceeding \$10 million fell by about 72 percent.<sup>6</sup>

One consequence of reduced IRS funding is the persistence of significant rates of tax non-compliance at the top of the income distribution. According to recent estimates, the top 1% highest earners in the United States under-report about 21% of their true income, of which 6 percentage points correspond to sophisticated forms of evasion such as the concealment of assets abroad and tax evasion in complex business structures.<sup>7</sup>

There is an urgent need to increase audit rates and fund more thorough audits for high-income and high-wealth individuals. Among other things, this would make it possible to make additional progress in the fight against offshore tax evasion.

## **5. A wealth tax: part of the ideal tax system**

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<sup>6</sup> See Written testimony of Charles P. Rettig, Commissioner of the Internal Revenue Service, before the House Ways and Means Committee, March 18, 2021, available at <https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/Final%20testimony%20HWM%20Oversight%20031821.pdf>

<sup>7</sup> J. Guyton, P. Langetieg, D. Reck, M. Risch and G.Zucman, "Tax Evasion at the Top of the Income Distribution: Theory and Evidence", NBER working paper #28542, March 2021.

Increasing IRS enforcement activities, although necessary, would not address the regressivity of the US tax system at the top-end. The solution to this issue involves a progressive wealth tax.

Why isn't the income tax enough? Quite simply because among the most advantaged members of society, many possess substantial wealth while having low taxable income. Maybe they own a valuable business that does not make much profit, but which, everybody anticipates, will be immensely profitable in the future. Or, as is more frequently the case, they may structure their already profitable business so that it generates little taxable income. In both cases, these billionaires can today live almost tax-free. A progressive wealth tax is part of an ideal tax system because wealth is an indicator of the ability to pay taxes, above and beyond income.

And a wealth tax can work. In the United States, property rights are well defined; most assets have clear market values; and when market values are missing, they can be estimated.<sup>8</sup> Before the creation of the federal income tax in 1913, income taxation was decried as impractical and dangerous—a fantasy imported by “European professors.”<sup>9</sup> Today, the federal income tax is widely recognized as a large success.

## **6. Transfers**

In this testimony I have focused on the progressivity (or lack thereof) of the US tax system. But of course, taxes are only one half of the government equation. With the revenue it collects, the US government funds transfers to families and provides public goods and services. This spending is progressive. The combination of a roughly flat tax system with a progressive transfer system means that the overall tax-and-transfer system is redistributive.

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<sup>8</sup> See E. Saez and G. Zucman (2019), “Progressive Wealth Taxation”, *Brookings Papers on Economic Activity*, Fall 2019, 437—511.

<sup>9</sup> See E. Saez and G. Zucman, *The Triumph of Injustice...*, op. cit, chapter 2.

However, the redistributivity of the tax-and-transfer system is limited. After taxes and cash transfers, the bottom 50% does not earn more on average than before taxes and transfers. In both cases, the average income of the bottom 50% was around \$18,500 per adult in 2018. The working class does not benefit, on net, from cash redistribution: the cash transfers it receives (including the refundable portion of tax credits) are about as large as the taxes it pays.

With a more progressive tax system, public spending on education, health, and infrastructure could be bolstered. It's through collective spending on education, health, and other public goods that rich countries—such as the United States—have become wealthy, not through low taxes for the ultra-rich. If history is any guide, the prosperous nations of the future will continue to be those that invest in the success of all.

I look forward to your questions. Thank you.