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Philanthropy Roundtable

WEALTH TAX PROPOSALS THREATEN PHILANTHROPY

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EXECUTIVE SUMMARY

- **RESURGENT POPULISM IS DRIVING CALLS FOR INCREASING TAXES ON WEALTHY AMERICANS**
- **WEALTH TAXES SHIFT FUNDS FROM CHARITABLE SECTOR TO GOVERNMENT AND RAISE ADMINISTRATIVE, CONSTITUTIONAL AND PHILOSOPHICAL QUESTIONS**
- **WHEN IT COMES TO GROWING PROSPERITY AND INCREASING CHARITABLE GIVING, WEALTH TAXES ARE COUNTERPRODUCTIVE**
- **POLICYMAKERS SHOULD REJECT PUNITIVE LAWS AND SEEK POLICIES THAT SUPPORT AND PROTECT THE CRUCIAL ROLE OF THE CHARITABLE SECTOR**

INTRODUCTION

The Philanthropy Roundtable believes the imposition of a wealth tax would have a long-term negative impact on the charitable sector. Shifting more resources from the voluntary sector to government will yield less for not only the major donors charities rely on, but also less for the charities themselves.

America is a vibrant, diverse country with myriad challenges and opportunities. Recent years have brought a renewed focus on income inequality and disparities in opportunities for numerous groups of Americans. Rather than coming together to address the root causes of social ills and working to foster opportunities for all to succeed and prosper, more voices have joined the call to punish the wealthiest Americans through the tax code. The overarching theme of these calls is, "[f]ailing to adequately tax extreme wealth contributes to economic inequality,"[1] and, "the time is long overdue for us to finally address the grotesque level of income and wealth inequality that exists."[2]

Some within the charitable sector support the concept of wealth taxes. Their argument is that if the government seeks to confiscate more money from wealthy individuals, those individuals will be more motivated to give increased funds away to charities in an effort to avoid the tax. This primer will explore the flaws in this argument and the threats to charitable giving posed by wealth taxes.

WHAT ARE WEALTH TAXES?

Generally, a wealth tax is a targeted tax on an individual's assets or net worth above a defined threshold. It is by nature, an arbitrary, punitive attempt to "level the playing field" by taxing those with more wealth at a higher rate than the existing income tax structure allows. The details of how various proposals define income and assets are largely outside of the scope of this primer, with one exception: the treatment of charitable assets. A disturbing feature of some proposals is the inclusion of assets within charitable foundations or other giving vehicles as assets subject to increased taxation.

While the details of U.S. wealth tax proposals vary widely, they share certain characteristics. All supporters aim to reassure average Americans they will not be hit by the tax as it is targeted only to the very wealthiest incomes no average American could ever expect to achieve. The talking points in support of the proposals are squarely focused on the concept of improving "fairness" and making sure those with the most wealth "pay their fair share." Across the board, these taxes target not only the return on capital, or income, but future presumptive returns.

One of the more recent proposals, for example, is a bill introduced in the Senate by Sen. Elizabeth Warren (D-MA), the "Ultra-Millionaire Tax Act," that would impose a 2% annual tax on the net worth of households and trusts between $50 million and $1 billion and a 1% annual surtax (3% tax overall) on the net worth of households and trusts above $1 billion.[3] This proposal is not triggered by income like the existing income tax structure, but rather by the assets already held by the individuals.

Unlike the tax proposal Warren promoted during her campaign for the White House, she does not specifically tax charitable assets in the latest bill.[4] However, the language puts the decisions on how to value assets into the hands of the Treasury Department, and her past proposals and recent comments suggest she remains open to this. For example, Warren demonstrated her openness to including charitable funds with personal assets when asked about eliminating tax deductions for philanthropy:

> … WE HAVE SO UNDER-TAXED THOSE AT THE TOP THAT IT'S HAD TWO CONSEQUENCES. ONE IS THAT IT'S PART OF THE REASON THEY'VE BEEN ABLE TO BUILD SUCH ENORMOUS FORTUNES, BECAUSE WEALTH ITSELF FOR THIS TOP GROUP HASN'T BEEN TAXED. BUT THE SECOND CONSEQUENCE IS THEY THEN GET TO USE IT IN WAYS THEY DECIDE THEY WANT TO USE IT. AND, LAST I SAW, THERE AREN'T MANY BILLIONAIRES MAKING CHARITABLE CONTRIBUTIONS TO ENFORCE SERIOUS ENVIRONMENTAL REGULATIONS, TO ENFORCE SERIOUS ANTI-MONOPOLY REGULATIONS, TO PUT IN PLACE A WELL-FUNDED ENFORCEMENT AGENCY TO MAKE CERTAIN THAT PEOPLE AREN'T GETTING CHEATED ON FINANCIAL PRODUCTS. NO, THEY WANT TO DIRECT MONEY IN THE WAYS THEY WANT TO SPEND IT. AND THAT'S FINE, BUT THAT DOESN'T RELIEVE THEM OF ONE PENNY OF THEIR RESPONSIBILITY TO MAKE A FAIR CONTRIBUTION TO WHAT IT TAKES TO RUN THIS NATION AND TO RUN IT NOT JUST FOR THE BENEFIT OF THE BILLIONAIRES BUT THE BENEFIT OF THE REST OF AMERICA.[22]

President Biden included a different approach in his FY 2023 budget proposal. Under his plan, (among other tax changes aimed at wealthy Americans) a new minimum tax of 20% on total income, including unrealized capital gains, would be imposed on taxpayers with net assets over $100 million.[5]

WEALTH TAX PROPOSALS RISE WITH POPULIST TIDES

Wealth redistribution has been attempted throughout history, with tragic consequences for nations' citizens and economies. While the U.S. has never levied an annual wealth tax specifically, calls for a wealth tax are not new. Waves of populism, or a sentiment that elites hold too much power over the government and economy vs. average Americans, accompany such pushes for taxing the rich.[6]

Two economists who support a wealth tax and have worked with presidential candidates on proposals, Emmanuel Saez and Gabriel Zucman, argue: "Concern about inequality is at least as old as the United States itself," and cite writings of James Madison that appear to connect "excessive wealth and its political influence."[7] More clear parallels to today are found in the 19th century industrial era where cultural angst was directed at wealthy captains of industry such as Cornelius Vanderbilt, and again during the Great Depression when wealthy families such as Mellon, Carnegie and Rockefeller faced social ire. Against this backdrop, it is clear why the income tax took hold and why a wealth tax regularly emerges as a proposed addition.

To understand why a wealth tax has not been implemented, it is useful to consider the challenges faced by proponents of the income tax. Apart from a 10-year income tax levied during the Civil War, an attempt was made to tax income in 1894 when Congress enacted a flat rate income tax. The following year, the U.S. Supreme Court ruled the tax unconstitutional as it was a direct tax, not apportioned according to the population of each state. In 1913, with the ratification of the 16th amendment, this objection was overcome by allowing the U.S. government to tax individuals' incomes, regardless of state population.

This primer will not outline a detailed history of the income tax structure from 1913 through today, beyond the acknowledgment that important expansions, contractions and revisions to the tax regime have accompanied war, financial crises and the tides of cultural sentiment.[8] However, the lesson learned from the long and winding road to an income tax structure is there are significant obstacles to overcome.

The current resurgence of populism may be connected to globalism and perceived or actual inequalities in the U.S. economy following the Great Recession of 2008.[9] It comes as no surprise that by the 2020 Presidential Election, several candidates for the Democratic nomination had wealth tax proposals among their planks.[10]

WHY IS A WEALTH TAX THE WRONG PATH FORWARD FOR A MORE PROSPEROUS, CHARITABLE AMERICA?

There are three major issues with attempts to impose a wealth tax in the U.S.: administrative challenges; constitutional questions; ideological threats.

ADMINISTRATIVE CHALLENGES

The first issue is that wealth taxes are unavoidably difficult to administer and enforce. In other developed countries, wealth taxes have been largely abandoned due to administrative challenges and other unintended consequences. The number of OECD countries with wealth taxes dropped to four by 2017 (at that point, France, Norway, Spain and Switzerland), down from 12 in 1990. Since 2017, France has also repealed its wealth tax. According to an OECD report, "Decisions to repeal net wealth taxes have often been justified by efficiency and administrative concerns and by the observation that net wealth taxes have frequently failed to meet their redistributive goals. The revenues collected from net wealth taxes have also, with a few exceptions, been very low."[11]

As a wealth tax is levied on assets, rather than income, one major administrative hurdle is how to value non-cash assets, especially those not traded on a public market. If a tax is owed on everything from art to privately held stock to resources in a charitable trust, the value of each must be determined annually according to a standardized metric. This challenge is not a minor one. As a Tax Foundation analysis notes, data suggest "that publicly traded assets only account for one-fifth of the assets held by the top one percent after excluding tax-exempt accounts, while private business assets represent more than one-half."[12]

Administering such a tax becomes exponentially more complicated if charitable assets associated with wealthy individuals are also taxed. Researchers with the National Taxpayers Union Foundation (NTUF) note, "There's little in the way of practical solutions to administrative difficulties Warren's wealth tax would face. In fact, the process of determining a taxpayer's net worth is almost entirely left up to the Secretary of the Treasury to figure out. … Prior experience shows that when independent agencies are allowed to make their own rules, they tend to err on the side of red tape. As a result, there's a risk that the agency may turn every wealth tax assessment into a never-ending blizzard of filings, appeals and legal challenges that dramatically reduce any utility derived from revenue extraction." The NTUF analysis looked specifically at Warren's proposal and estimated the impact on charitable foundation assets. If enacted, such a tax would be equivalent to between 6% and 25% of the annual disbursements of five selected foundations including the Dell Foundation, the Omidyar Network and Dalio Philanthropies, among others.[13]

According to the NTUF analysis, private foundations' tax liability would represent a significant percentage of their annual giving. For example, the $1.4 billion that Michael and Susan Dell (of computer maker Dell Technologies) would owe under Warren's wealth tax would represent more than 1,006% of their $136.9 million contribution to the Dell Foundation in 2020. The $658 million wealth tax bill for eBay founder Pierre Omidyar, meanwhile, would represent 1,719% of his 2020 contribution to the Omidyar Network.

Those who support wealth tax proposals may argue this is a positive impact, essentially acting as a forcing mechanism to turn private wealth to the public benefit. But even with tax liabilities this large, resulting revenues would represent a drop in the bucket of federal spending. For example, the $658 million wealth tax bill Pierre Omidyar would face would fund the government for less than an hour. The federal government would spend the entire $88.55 billion charitable foundations spent in 2020 in less than five days.[14] And this would come at the expense of significant charitable work that could be accomplished with the same funds.

When it comes to wealth tax proposals, the administrative challenges far outweigh the benefit to the Treasury.

CONSTITUTIONAL QUESTIONS

The primary argument against imposing a wealth tax in America is it may be unconstitutional. Dating back to the country's founding, the intention was that taxation of people and property, like representation, should be apportioned based on population so no state would be at a disadvantage.[15] Alexander Hamilton wrote in Federalist No. 36 that "tax apportionment was a key component of federalism, given that direct taxes could disrupt local economies in ways federal lawmakers couldn't even imagine."[16] As noted earlier in this primer, the constitutionality of taxing Americans' income was struck down in a Supreme Court decision from 1895, Pollock v. Farmers Loan and Trust Company, which spurred the passage of the 16th Amendment. However, the 16th Amendment is tailored to taxing "income," and wealth tax proposals stretch far beyond income into assets and unrealized potential gains.

There are legal scholars who argue a wealth tax would be constitutional.[17] Our goal here is not to settle the debate, but rather note there is significant controversy surrounding the constitutionality of a wealth tax.

IDEOLOGICAL THREATS

Calls to punish the wealthiest in society are symptoms of larger social issues and debates that get to the core of what America is and should be. Rather than cheering free market capitalism and working to ensure the equality of opportunity for all individuals to succeed, wealth tax proponents see the success of individuals as a danger to others that must be punished by the government for the sake of pursuing equality in outcomes. The result of a wealth tax would generally deter wealth creation through entrepreneurship, venture capital funding and even the migration of talent into the U.S.[18]

There is no question that the generation of wealth drives charitable giving. Punish individuals for economic success and charities will inevitably pay a price as well.

Arguments to include charitable assets in a wealth tax are indicative of a growing sentiment that government spending is preferable to civil society. Wealth tax proponents assume the income and assets of wealthy Americans belong first to the government, not to those who have earned and saved. Proponents see the wealth of individuals in society as a barrier to creating a welfare state with the government at the helm of spending to address the nation's challenges, rather than individuals organizing to meet these challenges voluntarily.

And most disturbing of all: that it is preferable to rely on the government to meet the needs of our communities rather than fostering a strong and vibrant civil society, in which Americans of all income levels can come together to address the causes that matter to them with the unique resources, creativity and skills that all have to offer. This is not a new theme. It has long been a goal of philanthropic freedom opponents to formally annex charitable dollars as government dollars.[19]

As Margaret Thatcher said in a 1974 UK Parliament, House of Commons debate, "A capital transfer tax does not redistribute wealth, nor does a wealth tax. They concentrate wealth in the hands of the government, which is the very opposite of distribution. They strengthen the economic power of the state against the individual."[20]

Some even contend the mere existence of wealthy individuals causes social harm, thus wealth taxes help to heal society beyond the redistribution of wealth. Economists Saez and Zucman claim: "Extreme wealth concentration, like carbon emissions, imposes a negative externality on the rest of us. The point of taxing carbon is not to raise revenue but to reduce carbon emissions. And the point of high tax rates on the very highest incomes is not fundamentally to fund government programs. They are aimed at reducing the income of the ultra-wealthy."[21]

Of course, as noted above, there are those within the charitable sector who argue a wealth tax would benefit charities by spurring more voluntary giving. Yet, while this very well may be a short-term impact, the net long term effects are negative for the sector with fewer private resources available to donate over time.

Punitive policies that simply target success are rarely effective in reaching our shared social goal of increasing prosperity for all Americans. Particularly when charitable resources are in the crosshairs, wealth tax proposals will result in less charitable giving and less of the economic activity that provides opportunities for those in every tax bracket. While the rest of the world moves away from such tax schemes, lawmakers should reject proposals to impose a wealth tax.

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ABOUT PHILANTHROPY ROUNDTABLE

Philanthropy Roundtable is a nonprofit organization dedicated to building and sustaining a vibrant American philanthropic movement that strengthens our free society. To achieve this vision, the Roundtable pursues a mission to foster excellence in philanthropy, protect philanthropic freedom and help donors to advance liberty, opportunity and personal responsibility.

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