The Constitutionality of Implementing Wealth Taxes in America

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In an era of widening economic inequality–with the top 1% of Americans owning more than the entire bottom 90% combined–the idea of taxing extreme wealth has become increasingly popular amongst lawmakers and the public alike. The combination of stagnant wages and rising living costs has contributed to the massive wealth gap that exists between the elite and the middle class. Proposals like Elizabeth Warren's Ultra-Millionaire Tax Act have called for an annual tax on the net worth of America's richest households. Supporters view this bill as a way to narrow down the wealth gap and fund public services, while critics raise concerns about the legality, enforceability, and fairness of it. Unlike the income tax that most Americans pay, a federal wealth tax would target owned assets, not the income they generate. The constitutionality of a federal wealth tax hinges on its classification as a direct or indirect tax, the scope of the 16th Amendment, and the extent to which equal protection under the law applies, making the debate over its legality highly complex.

By definition, a wealth tax refers to a tax imposed on an individual's total net-worth–including but not limited to assets like real estate, stocks, bonds, property, and luxury goods–minus any debts. Unlike income taxes that are levied on annual earnings, a wealth tax would apply to accumulated assets which often grow untaxed over a substantial period of time. The profits made from such assets contribute heavily to the wealth gap between upper class citizens who invest, and the general public. Proponents of the wealth tax argue that it could generate trillions of dollars in revenue, which could then be used to improve society. This money could help reduce student debt, expand public services, fund education, and improve infrastructure. Specifically, Senator Elizabeth Warren proposed the Ultra-Millionaire Tax Act which would implement a 2% annual tax on assets exceeding $50 million, and a 1% surtax on assets exceeding $1 billion. Supporters of this bill believe that it would create a fairer economy by taxing the top 0.05% of society. However, critics argue that this type of taxation could lead to a wide range of negative consequence, both practically and constitutionally. It could discourage investment and entrepreneurship by penalizing individuals who save instead of spending or reinvesting funds. Additionally, wealth taxes would be difficult to properly administer since it is unclear how to accurately measure and value assets such as private businesses and collectibles.While income is recorded in tax returns and payroll systems, wealth would be much more difficult to track. This would raise serious issues of underreporting and evasion. Enforcement of a wealth tax would likely require a drastic expansion of IRS inspection, potentially evoking civil liberty violations. These concerns translate to the broadly held belief that a federal wealth tax would never function in America.

The constitutionality of a federal wealth tax depends largely on its characterization as either an indirect or direct tax. The 16th Amendment, effective in 1913, authorizes Congress to levy an income tax without apportioning it among the states. However, the 16th Amendment refers only specifically to “incomes” and not to wealth or property. If a wealth tax is found to be a direct tax, it would have to be apportioned evenly amongst states–an option that is practically impossible to fulfill as personal wealth isn’t equal amongst states. Specifically, in the case Pollock v. Farmers’ Loan & Trust Co, the Supreme Court declared the taxes levied on income from real estate and personal property unconstitutional due to its classification as direct tax. Beyond taxation concerns, a federal wealth tax would have to face due process and equal protection under the Fifth and Fourteenth Amendments. Critics say that charging people based on the mere accumulation of wealth may infringe on the right to due process, especially due to potential government overreach. The Fifth Amendment prohibits the government from depriving an individual of “life, liberty, or property without due process of law.” As wealth taxes would be levied on property, imposing taxes on wealth that is not actively generating income could be depriving an individual of their property rights. Furthermore, if a wealth tax is only imposed on a small fraction of Americans, it could be viewed as unfairly discriminatory even if the goal of the tax was to reduce economic inequality.

Besides constitutional concerns, the administrative and logistical challenges of imposing a federal wealth tax are considerable. It would be difficult for the IRS to value net worth fairly each year by needing to create new valuation methods and data systems that are capable of tracking assets like art, real estate, private businesses, and foreign bank accounts. This would encourage aggressive tax avoidance and evasion strategies. Internationally, wealth taxes have been implemented and seemed to have been unsuccessful. In 2018, France repealed its net wealth tax and replaced it with a tax on real estate. One of the main issues with the wealth tax in France was that it led to excessive emigration of the wealthy. Germany, Sweden, and Denmark also abolished wealth taxes due to low revenue yields and high administrative costs. In each case, the government found that the implementation of wealth taxes was too difficult to outweigh the benefits. In the U.S, where the IRS is already underfunded, enforcing such a tax would require an expansion of power and infrastructure that could be out of the nation’s reach; it would likely provoke public resistance as well as constitutional lawsuits.

Given the legal and practical difficulties in enforcing a wealth tax, many legal scholars, economists, and policy makers advocate for alternate reforms that could reduce inequality without creating complications. A viable option would be to impose a financial transaction tax on stock trades. Some economists believe that a small tax levied on stock trades could reel in revenue and slow down risky trading. Since a financial transaction tax would not be levied on total wealth but specific transactions, it could be classified as an indirect tax that wouldn't have to be apportioned amongst states. However, this could lead to traders emigrating from the country to avoid the tax, limiting the profits that the U.S would gain. This would greatly harm corporations that trade millions of stocks everyday. Critics worry that an FTT would make the stock market less busy, causing inconsistent stock prices, potentially hurting retirement accounts and investments that people rely on. Some argue that raising the capital gains tax imposed on investments by aligning it with normal income tax rates would be a viable option, but this tax would face all the consequences that a wealth tax would have in enforcement.

While the idea of a wealth tax may stem from a desire to reduce the rising economic inequality in the states, the constitutional and administrative obstacles in enforcing this tax make it highly impractical to implement. The classification of a wealth tax as a direct or indirect tax is unclear, making it a target to be struck down by courts. There are logistical difficulties in being able to value assets such as art and real estate, imposing burdens on the already underfunded and understaffed IRS. Countries in Europe like France, Germany, and Sweden have repealed their wealth taxes due to low revenue returns, high administrative costs, and widespread public disapproval. In the United States, a wealth tax could prompt wealthy individuals to similarly emigrate to avoid these taxes, discouraging economic productivity and ultimately harming economic growth. Given these challenges, alternative options like reforming a capital gains tax and imposing a financial transaction tax may bring benefits, but will likely not function in the United States. Ultimately, while wealth taxes may seem like a promising solution to address economic disparities, it is far too difficult to enforce in America.

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