Emmanuel Saez and Gabriel Zucman: The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay

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The book *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay* (Saez and Zucman, 2019) by Berkley professors Emmanuel Saez and Gabriel Zucman is mainly a book about taxation in the United States. It contains some comparisons to other countries and is certainly relevant beyond the US. The book gives a short overview of the history of taxation in the US and describes how a tax system that used to be highly progressive (meaning that richer people paid a higher share of their income in taxes than poorer people) became less and less progressive, up to the point where the richest of the rich pay a lower fraction of their income in taxes than the middle class, which is the case at the moment.

The book is a book about taxation, but it is also a book about inequality. The authors elucidate the two-way interaction between taxes and inequality. Taxation naturally influences the development of inequality in a society. However, inequality similar influences taxation via the influence that wealthy people have on politics and therewith on which taxes are levied, how high tax rates are, and what the rules and norms for the enforcement of the tax collection are.

The US used to have highly progressive taxes for most of its history, especially in the decades after the second world war when US economy and society were thriving. Measuring who pays how much tax effectively is not an easy task – at the end, all taxes are paid by people, but many taxes (as one example the corporate income tax) are levied in a way that do not make it obvious who pays. To measure the effective tax payments, the authors largely rely on a relatively new methodology that they developed themselves, jointly with Thomas Piketty (Piketty et al., 2018).¹

The authors describe how the tax system has slowly become ever more favorable to the rich in the past decades. In the fifties and sixties, the richest 0.1% of individuals paid on

¹ Thomas Piketty's book *Capital in the 21st Century* (Piketty, 2014) is one of the major recent contributions putting inequality in the spotlight.

average about half of their income in taxes whereas the population excluding the richest 10% paid on average only a quarter to a fifth. This changed slowly over the decades. Currently, all income deciles pay with about 25% to 30% a similar fraction of income in taxes. Taxes are mildly progressive for most part of the income distribution, but they become even regressive at the very top of the income distribution: in 2018, for the first time in history, the richest 400 Americans paid on average a lower fraction of their income in taxes than the poorer half of society. This decrease in tax progressivity went hand in hand with an increase in inequality so severe that the richest 1% of society now earn more than 20% of national income (as compared to about 10% forty years ago), while the bottom half of society only earn 12% (as compared to about 20% forty years ago).

There are two main direct contributors to the decrease in tax progressivity in the past decades. The first is tax evasion and avoidance.² The second is a decrease in tax rates benefitting the rich. Saez and Zucman illustrate well how these two factors often came together, increases in tax evasion and avoidance being followed in steps by decreases in tax rates, justified by the argument that taxes must go down as they would otherwise be evaded or avoided. However, this argument may not stand up to scrutiny.

The authors make the point that tax avoidance and evasion are not as unpreventable as often thought. This is in particular the case as corporate taxes, the taxes that are most severely avoided, are not avoided by moving actual physical capital. If a firm “relocates” to a tax haven, it merely shifts paper profits. Such avoidance or evasion was not tolerated in the US during most of the 20th century. The law of the United States contains the so-called economic substance doctrine, which makes transactions illegal that have as sole purpose to reduce tax liability. This doctrine seems to have been applied much more consequently in the history of the US than nowadays. In addition, there was a clear consensus among lawmakers in the past that, if the law was not sufficient to curb tax evasion or avoidance, the law should quickly be modified. The authors describe how Congress reacted quickly in 1937 to outlaw multiple tax avoidance schemes that had appeared such as setting up foreign personal holding corporations in the Bahamas or Panama. Unfortunately, quick and determined reactions to tax avoidance schemes are no longer common, not only in the US but in many countries. According to the authors, about 40% of all multinational profits are booked in tax havens, globally.

Underlining their argument with such historical examples and some data, the authors stress that letting people avoid taxes is a choice of society. It is not an explicit or deliberate decision, but what the law states and whether the law is strictly enforced depends on

² The authors rightly note that the distinction of tax evasion and tax avoidance is not as clear cut as the industry of tax lawyers and consultancy firms tries to portray. The book describes this in the context of the US, but it holds similarly in other countries. The massive cum-ex tax fraud that cost Germany billions of tax money, for instance, was also described as legal tax avoidance by some interested parties such as law firms, despite the fact that it was clearly illegal (which was also confirmed by German courts thereafter). Unfortunately, the German authorities enforced the law insufficiently with huge losses for society.

government and Congress (including decisions about whether the Internal Revenue Service receives enough means to be able to enforce the law). In most of US history, tax avoidance and evasion were kept under control and they could be curbed again in the future.

Except for curbing tax avoidance and evasion via better laws and stricter enforcement of the rules (including the creation of an agency regulating tax-related services similar to the Consumer Financial Protection Bureau), Saez and Zucman offer various ideas on how the tax system could be made fairer. This includes ideas that have been around for a while such as a progressive wealth tax, which seems useful as it raises revenue by directly addressing the problem of severe wealth inequality. The authors also argue in favor of more progressive personal income taxes, taxing labor and capital at the same rate, as income can often be shifted from one to the other (a lawyer, for instance, may found a small company and pay herself capital income instead of labor income).³

A non-standard idea to improve the tax system is an effective minimum corporate tax. According to this proposal, countries would impose a minimum corporate tax rate (of, for example, 25%). Preferably, countries would agree jointly on such a tax rate, but the beauty of the proposal is that it is not strictly necessary: countries could partially tax foreign companies, up to a limit determined by the proportion of sales in the home country. More precisely, countries could collect a proportion of the tax deficit of a foreign company, which is the tax that is missing to the minimum effective tax rate. That is, if the US implements a minimum corporate income tax of 25% and 10% of a Swiss company's sales are in the US, while the company only pays a tax rate of 5% on its global profits, the US would charge the company a tax of 2% of its global profits (the tax deficit would be $25\% - 5\% = 20\%$ and 10% thereof, which corresponds to the sales in the US, would be 2%). This solution seems easy to implement and in agreement with current tax treaties.

To raise additional revenue, the authors propose what they call a national income tax (instead of value added or sales taxes). This tax would be a flat tax in addition to the progressive personal income tax, levied on all income independent of whether it arises from labor or capital and on which sector it arises from. The authors suggest no deductions and not to exempt savings.

The book makes a good case that taxation in the US has become highly unfair and makes suggestions how to address this problem. What about the weaknesses of the book? There are not many, but for my taste, there could have been more details about the suggested tax reforms. The suggestions clearly go in the right direction and some of them seem rather obvious (such as the introduction of a progressive wealth tax – at what rate exactly wealth should be taxed is a more difficult question, though) but others are not as trivial. I would

³ Some readers may remember a textbook result that optimal capital taxes are zero. However, the models are not supported by empirical evidence. Saez and Zucman show how actual saving behavior is the opposite of the assumptions in those models.

have liked to see more detail on the corporate income tax proposal and especially on the flat national income tax. How exactly can these be implemented and administered, what are the legal challenges, what are the most likely induced behavior changes, which possible drawbacks do the reforms have and how could the drawbacks be mitigated? The authors answer some of these points, but more detail would – at least for an academic reader – have been welcome.

Overall, the book provides a concise and well-written account of the problems with taxation in the last decades. It provides some solutions to the existing problems and is certainly a great starter for any discussion about optimal taxation and tax avoidance. I highly recommend reading it.

References

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