

Private Request for Analysis: The WhyNot Initiative

Budgetary and distributional analysis of a progressive AGI surtax

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Contact: John Ricco (john.ricco@yale.edu)

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Key Takeaways

1. The proposed 10% surtax on Adjusted Gross Income (AGI) above \$1 million (\$2 million for joint returns) would raise approximately \$1.5 trillion over the next ten years.
2. The tax would be highly progressive by design, raising taxes only on those in the top 1% of income earners – a group that receives nearly one quarter of total AGI.
3. While effective at taxing a broader income base than current tax law, the proposal's revenue potential is somewhat limited by behavioral responses to capital gains taxation. A more comprehensive reform that additionally addresses step-up in basis at death would lead to more revenue.

Proposal

This report analyzes a proposal to add a new 10% tax on Adjusted Gross Income (AGI) above \$1 million (\$2 million for joint returns). This surtax differs from normal tax rates in that it is assessed on a broader measure of income prior to deductions and does not offer lower rates for capital gains and dividends. The policy would be effective beginning in 2026 and the AGI thresholds would be indexed to inflation.

We estimate both the budgetary and distributional impacts of this proposal using the Budget Lab's open-source [Tax-Simulator](#) model; more detail about this model, including its underlying data sources, can be found [here](#).

Background: Top Incomes in the United States

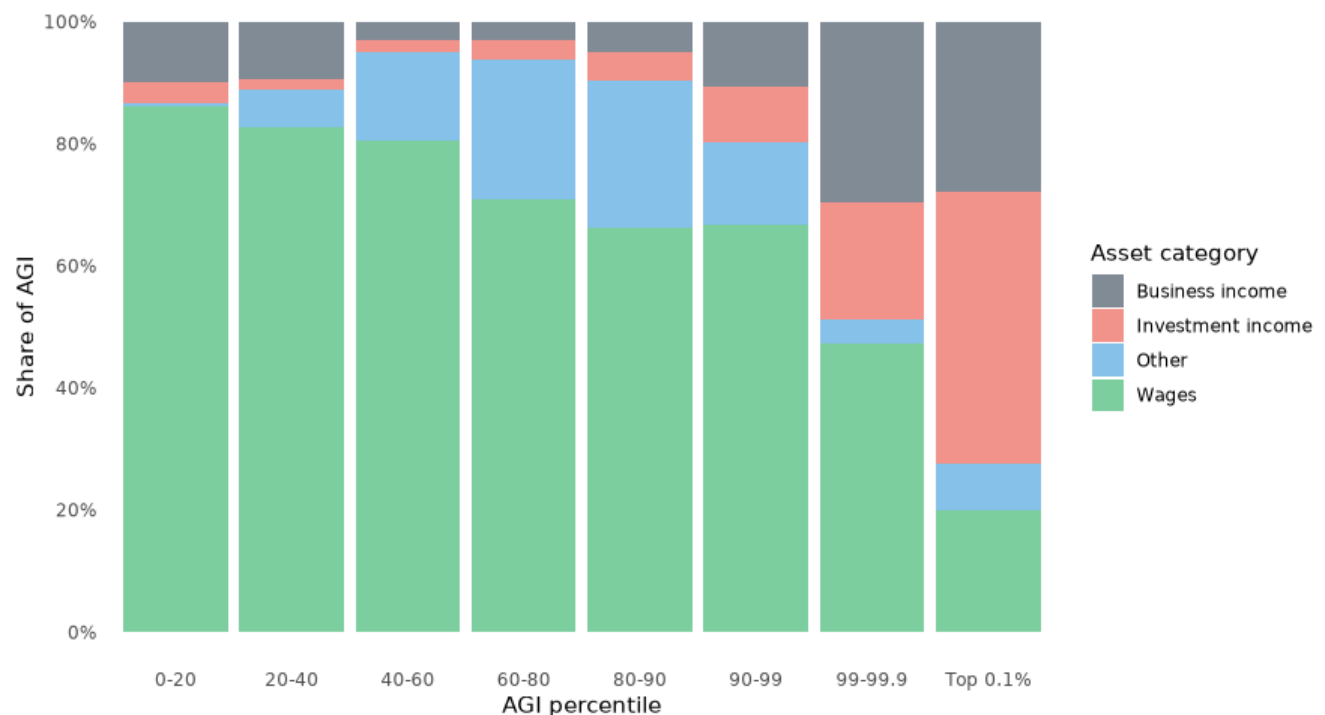
Income inequality has been a perennial political and academic issue in the United States for decades. Policymakers, economists, and citizens continue to debate both the extent of inequality and the appropriate policy response. Research suggests that income inequality has risen in recent decades, though the magnitude of this rise [depends on measurement choices](#).

Table 1 reports summary metrics for the Budget Lab's projected top incomes in 2026. We estimate that the top 1% of all tax units (the unit of people who file taxes together) will earn nearly one quarter of total AGI. For the top 0.1%, the cutoff for which begins at about \$3.5 million, that figure is 12%.

Table 2. Projected AGI Statistics, 2026

AGI group	AGI threshold	Number of tax units	AGI (trillions)	Share of AGI
Top 10%	\$192,055	18,911,300	\$9.3	50%
Top 1%	\$666,680	1,891,000	\$4.2	23%
Top 0.1%	\$3,468,815	189,100	\$2.2	12%
Top 0.001%	\$22,151,440	18,900	\$1.0	5%

One important fact about top incomes is that the composition of income varies by income group. Higher-income taxpayers are much more likely to derive their income from businesses and passive investments than from labor, as shown in Figure 1. One reason for this dynamic is that income for tax purposes is defined on a realization basis rather than an accrual basis. This means that, in any given year, some portion of those appearing in the highest income brackets are not permanently high-income individuals but rather taxpayers experiencing a one-time income event, particularly from capital gains realization (for example, when an entrepreneur sells their business or an investor liquidates a long-held position).

Figure 1. Projected Composition of Income by, 2026

Background: Taxation of Top Incomes Under Current Law

Progressive taxes represent one of the primary tools for addressing concerns about income inequality. Under current law, high-income individuals face several key provisions. The Tax Cuts and Jobs Act (TCJA) established a top marginal income tax rate of 37%, which is scheduled to revert to 39.6% when these provisions expire.

But the applicability of these top statutory rates is diminished by several features of the tax code:

- **Preferential rates for capital gains and qualified dividends.** These forms of income are taxed separately from other forms of income and are subject to a schedule of lower rates (top rate of 20% plus the 3.8% Net Investment Income Tax) compared to ordinary income (top rate of 37%). This creates a substantial tax advantage for individuals who derive larger portions of their income from investments rather than wages, which, as shown in Table 3 above, tends to be the case for high-income taxpayers.
- **Itemized deductions.** Some taxpayers can reduce their taxable income through various itemized deductions for certain expenses like charitable contributions and mortgage interest. In recent years, only about one in ten filers itemizes, and those who do tend to have higher incomes than those who do not.
- **Qualified Business Income (QBI) deduction.** Allows owners of pass-through businesses (S corporations, partnerships, and sole proprietorships) to deduct up to 20% of their business income, effectively reducing the top rate on this income by 7.4 percentage points (20% of 37%). Like most of TCJA's noncorporate tax provisions, the QBI is scheduled to expire at the end of 2025.

A surtax on AGI would avoid these leakages by applying to income before most deductions are taken and by treating all forms of income equally, regardless of source.

But even with a tax base of AGI instead of taxable income, the realization-based nature of income taxation remains a challenge for taxing high incomes. Under current law, appreciation in asset values goes untaxed until the asset is sold, and may not be taxed at all if held until death due to “step-up” in basis. This creates an incentive for investors to defer realization and for investment income to take the form of capital gains. For wealthy individuals, this dynamic gives rise to a tax strategy experts call the “[buy-borrow-die](#)” maneuver: rather than selling appreciated assets and triggering capital gains tax, individuals can borrow against their holdings to fund consumption, then wipe out tax liabilities at death. This strategy leads to extremely low effective tax rates on income (measured inclusive of unrealized gains) for early investors in successful businesses. It also means that increases in tax rates, even on AGI rather than taxable income, are somewhat limited in their revenue potential, since investors tend to sell assets less frequently – or not at all – when tax rates rise. A more fundamental approach to reform, for example treating death as a realization event or including accrued gains in taxable income, would be necessary to circumvent this issue.

Budgetary Effects

We estimate that the proposal would raise \$1.5 trillion over the next ten years. In the longer run, the budgetary effects grow slightly as a share of the economy. This reflects the fact that income growth tends to outpace inflation in the long run, and a thus larger fraction of taxpayers would be subject to the tax over time.

Table 3. Estimated Budgetary Effects, 2026-2055

<i>Billions of dollars</i>											<i>Share of GDP</i>		
2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	Budget window	Budget window	Second decade	Third decade
111	142	145	140	143	149	155	162	169	177	1,494	0.40%	0.42%	0.46%

As described above, capital gains are a large component of AGI at the top and are highly responsive to tax rates. These revenue estimates reflect the [standard Budget Lab assumption](#) that taxable capital gains

realizations would fall in response to higher tax rates. In the case of this specific tax proposal, there are three margins of possible behavioral adjustment:

- **Retiming to stay below AGI surtax threshold:** High-income taxpayers would likely manage the timing of their capital gains realizations to remain below the \$1 million (\$2 million for joint filers) AGI threshold when possible. This might involve spreading large sales across multiple tax years or coordinating realizations with years of lower ordinary income.
- **Selling assets less frequently:** The additional 10% surtax would increase the lock-in effect, where investors retain appreciated assets longer than they otherwise would to defer tax liability. Economic research consistently shows that higher tax rates lead to reduced trading activity and lower realization rates, which reduces revenue.
- **Holding more gains until death:** The surtax would strengthen incentives to pursue the "buy-borrow-die" strategy, where wealthy individuals hold appreciated assets until death to take advantage of the step-up in basis, increasing the amount of after-tax inheritances for heirs. Repealing step-up in basis at death would mitigate this behavioral response and increase the revenue potential of this

Distributional Effects

Table 3 shows estimated effects by income group.¹ The tax would be distributionally progressive by design, with higher income groups seeing larger tax increases as a share of income.

Table 3. Estimated Distributional Effects by Income, 2026

Income group	Income cutoff	Average tax change	Share with tax increase	Percent change in after-tax income
Quintile 1	\$0	\$0	0.0%	0.0%
Quintile 2	\$21,875	\$0	0.0%	0.0%
Quintile 3	\$44,435	\$0	0.0%	0.0%
Quintile 4	\$76,925	\$0	0.0%	0.0%
Quintile 5	\$138,410	\$5,245	1.3%	-2.0%
Top quintile breakout				
Top 10%	\$212,225	\$10,490	2.6%	-2.7%
Top 5%	\$305,240	\$20,975	5.1%	-3.5%
Top 1%	\$774,855	\$104,735	25.4%	-6.2%
Top 0.1%	\$3,655,635	\$944,860	96.6%	-11.9%

Income is measured as AGI plus: above-the-line deductions, nontaxable interest, nontaxable pension income (including OASI benefits), and employer-side payroll taxes. Income percentile thresholds are calculated with respect to positive income only and are adult-weighted.

¹ Note that, for our standard distribution tables, we use a slightly broader definition of income than AGI. More detailed can be found [here](#).

The age distribution of the tax burden, presented in Table 4, reflects typical lifecycle income patterns. Tax liability under the proposed surtax increases with age, reaching its peak during prime earning years (50-65) when individuals typically achieve their highest earning potential. The burden then diminishes somewhat during retirement years as income sources shift and overall income generally declines. This pattern aligns with established economic research on lifetime earnings trajectories, where income rises through mid-career before tapering off in later years.

Table 4. Estimated Distributional Effects by Age, 2026

Age group	Share of tax units	Average tax change	Share with tax increase	Percent change in after-tax income
24 and under	7.8%	\$25	<0.1%	-0.1%
25 - 29	7.5%	\$125	<0.1%	-0.3%
30 - 39	19.3%	\$405	0.1%	-0.7%
40 - 49	16.1%	\$1,115	0.3%	-1.2%
50 - 64	21.9%	\$1,685	0.4%	-1.5%
65+	27.4%	\$1,490	0.3%	-1.4%

Income is measured as AGI plus: above-the-line deductions, nontaxable interest, nontaxable pension income (including OASI benefits), and employer-side payroll taxes. Age group is determined by the age of the head of household. In some cases, "0.0%" may be slightly larger than zero and reflects rounding.