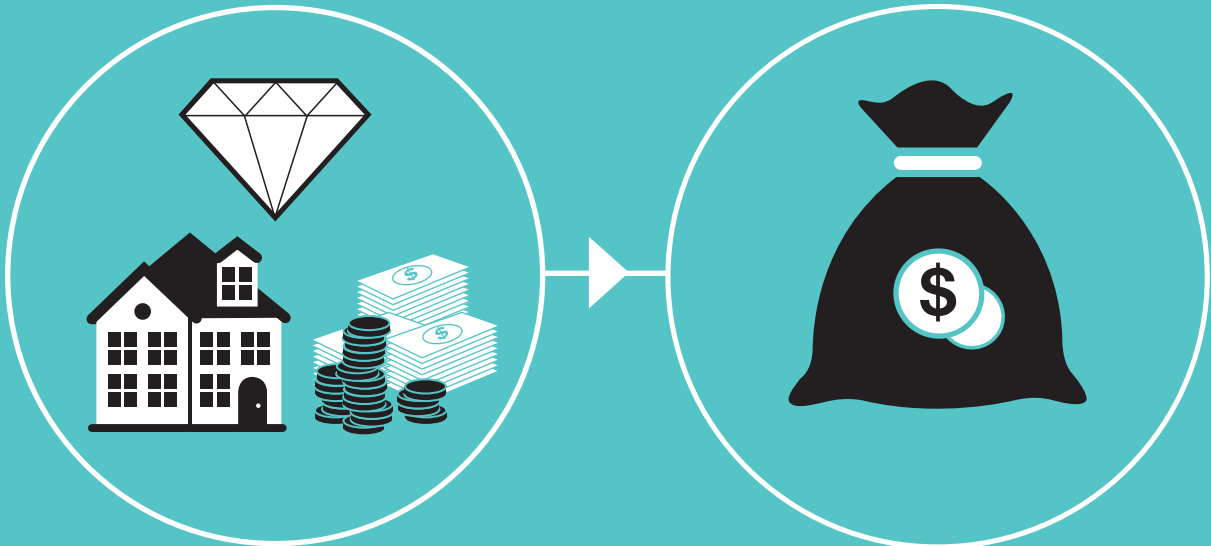


# Wealth taxes

## Progressive Taxation Briefing



## What are wealth taxes?

Wealth taxes can be imposed on the **holding** of wealth, the **transfer** of wealth, or the **appreciation** of wealth. Taxes on the holding of wealth, known as comprehensive wealth taxes, are fairly rare around the world. They tax a person's 'net worth' (assets minus liabilities). These assets can include (but are not limited to) cash, bank deposits, shares, personal cars, assessed value of real property, pension plans and so forth. Taxes on the transfer of wealth usually refer to inheritance taxes, estate taxes, and taxes on donations or gifts. Taxes on the appreciation of wealth usually take the form of capital gains taxes (CGT).<sup>1</sup>

**Wealth taxes can reduce inequality while raising revenue**, but countries have often struggled to design and administer viable and politically palatable wealth taxes.<sup>2</sup> Tracking down assets, assigning a value for tax purposes, and attributing them to individual taxpayers entails substantial costs. Comprehensive wealth taxes can become riddled with costly

special exemptions, meaning they end up raising remarkably little revenue.<sup>3</sup> For example, in 2015 the finance minister of **India**, a country with 131 dollar-billionaires, reported that repealing its wealth tax resulted in a revenue loss of some 10 billion rupees (the rough equivalent of US\$150 million).<sup>4</sup> More countries are repealing wealth taxes (including inheritance and estate taxes) than adopting them.<sup>5</sup>

**Taxing the rich can be very difficult.** Research in **Uganda** in 2013/14 found that only 35% of the top 60 lawyers in the country paid any personal income tax in 2013-14; only 5% of company directors did so; and only one of 71 high-level government officials, who owned considerable assets, had ever paid personal income tax.<sup>6</sup> Tax authorities have limited capacity or influence on legislation, and the very rich often hide their assets in tax havens. Credible estimates suggest that at least 30% of African financial wealth is held offshore,<sup>7</sup> with the corresponding figure for Latin America being 22%.<sup>8</sup> While international tax information exchange systems have been gradually developing, their scope and functionality is still far from satisfactory and access for developing countries is often limited, making it difficult for the tax authorities of these countries to track and tax their citizens' assets abroad.

According to influential French economist Thomas Piketty, **wealth taxes are underutilized**. He argues that, in an economy where the rate of return on capital investment exceeds the rate of growth, inherited wealth will always grow faster than earned wealth, thus making increasing inequality inevitable unless there is bold action by governments.<sup>9</sup> In practice, taxes on holding and transferring wealth tend to make up less than 1% of tax revenue in OECD countries, with taxes on income (such as personal and corporate income taxes) and consumption (such as VAT and excise taxes) making up the bulk.<sup>10</sup>

Tax on the appreciation of wealth is the form of wealth tax that tends to generate the most revenue. In both the UK and Australia, for example, CGT usually accounts for around 2% of tax revenue.<sup>11</sup> In emerging economies, comprehensive wealth taxes are rarely used. CGT is for example not used in Brazil, Indonesia, China and with its recent removal, no longer in India either.<sup>12</sup> There has also been a decline in wealth transfer taxes (such as inheritance taxes) in developing countries, with Sri Lanka, Bangladesh, Pakistan and Indonesia among those removing them in the last decade.<sup>13</sup>

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## How can wealth taxes be made more progressive?

**Wealth taxes are inherently progressive as wealth inequality is on average twice as large as income inequality.**<sup>14</sup> Ensuring that people pay tax on their wealth will therefore be a more progressive measure than increasing taxes on income. Any tax system that has weak or no wealth taxation is therefore likely to become much more progressive by introducing wealth taxes.

Introducing taxes on holding wealth can also stimulate economic activity and spur growth. If holding wealth is exempted from tax but earning an income is taxed, the wealthy have little incentive to use their capital productively. If land ownership is taxed, landowners are more likely to make use of the land or sell it to someone who will,

potentially creating employment and streams of tax revenue in the process. The same goes for cash and cash equivalents which can be invested and support jobs and income generating activities if the incentive to leave the capital unused is removed. This will in turn generate a wider tax base and increased tax revenues. Encouraging wealth to be used productively through tax policy can therefore have progressive impacts.

## Piketty's Global Wealth Tax

While ensuring that many different forms of wealth are taxed, governments should also consider co-operating to introduce a form of global comprehensive wealth tax as proposed by French economist Thomas Piketty. In his landmark 2013 book *Capital in the Twenty-First Century*, Piketty proposes a global wealth tax. It would be a globally-applied comprehensive wealth tax on holding wealth. The rates would be 1% on wealth between €1 million and €5 million, and 2% on wealth above €5 million.<sup>15</sup>

Piketty estimates that if such a tax were introduced in the EU, it would affect 2.5% of the population and generate around 2% of GDP as tax.<sup>16</sup> The revenue raised would be transferred to the country where the taxpayer is resident for tax purposes, not where the wealth is held. Such a system would be heavily reliant on effective information-sharing between countries on the financial assets and liabilities on individuals. There would have to be heavy sanctions on non-complying jurisdictions and tax havens. Piketty concedes that there is little political appetite for such a system and that it is unlikely to be realized in the near future, but with effective information-sharing, there are few technical obstacles to introducing such a tax.

In 2016, ActionAid calculated the hypothetical revenue gains from a 5% global wealth tax on wealth over US\$1 million as US\$5.795 trillion; at 1% it would be US\$1.159 trillion.<sup>17</sup>

## Examples of good and bad uses of wealth taxes

It is hard to assess wealth taxes in many developing countries as they either do not exist or are not very effective. However, the examples below from Colombia and South Africa can provide some guidance for how to develop effective wealth taxes.

A study of wealth taxes, including comprehensive wealth tax, and the reactions of the rich to them in **Colombia**, showed that the country needed increased capacity to collect and verify information from third parties (such as financial institutions) about the financial position of a taxpayer. More capacity was also needed to verify the assets of companies owned by wealthy individuals, such as ensuring that stocks, inventories and liabilities were not assigned to third parties to hide wealth. It also confirmed that the wealthier a taxpayer was, the more likely they were to evade taxes. Finally, it found that tax amnesties could be used to persuade wealthy individuals to declare assets, foregoing previously uncollected taxes but registering the wealth for future taxation.<sup>18</sup>

**South Africa** is struggling to introduce an effective tax on holding wealth. The country currently has a transfer

duty, estate duty and donations tax which are all taxes on transferring wealth. The South African Revenue Service (SARS) has concluded that a tax on holding wealth is not feasible now, but has proposed that all personal income taxpayers above the filing threshold be required to submit a statement of all assets and liabilities from 2020.<sup>19</sup> This would help track wealth and inform future policy on a potential tax on holding wealth.

There are many different forms of taxing the holding of wealth in European countries, and some of these models may be interesting for developing countries. For example, in the **Netherlands**, there is a flat tax of 1.2% on the total value of savings and investments above €21,139.<sup>20</sup> Investments of up to €56,420 in pre-approved 'green' investments are exempted.

Until 2017, **France** had a 'Solidarity Tax' on wealth. It was a progressive tax starting at 0.5% of held wealth above an €800,000 threshold. There were various thresholds and rates above that, with 1.5% being the top rate for wealth above €10 million. It was estimated that in 2007 the tax generated €4.42 billion, or 1.5% of total tax take in France.<sup>21</sup> Both **Spain** and **Switzerland** have progressive wealth taxes that differ slightly among municipalities and regions, varying between 0.2% and 3.75% in Spain,<sup>22</sup> and between 0.13% and 0.94% in Switzerland.<sup>23</sup>

## Recommendations

### ▶▶ Governments should:

- *Prepare for comprehensive wealth taxes with mandatory declarations of assets and liabilities, as in South Africa.*
- *Improve transparency of wealth by introducing robust automatic exchange of information systems with other tax authorities, through a reformed OECD Global Forum on Transparency & Exchange of Information for Tax Purposes<sup>24</sup> or otherwise, as well as updated registers of beneficial ownership which are publicly available, free of charge, and verified.*
- *To reduce the risk of capital flight, consider a regional approach to wealth taxes, introducing standardized taxes on holding wealth at a continental or trade bloc level with a view to negotiating a global tax on held wealth in the long term.*
- *Establish a specific unit in the tax authority to deal with taxing the wealthy.<sup>25</sup>*
- *In the absence of a comprehensive tax on holding wealth, countries should tax the holding, transfer and appreciation of wealth through different taxes (such as property, inheritance and capital gains taxes), to make them harder to avoid.*
- *Ensure whistleblowing protection for those who expose tax avoidance schemes by the ultra-wealthy.*

This is one of a series of briefings on Progressive Taxation published by ActionAid International in October 2018. You can find them at [www.actionaid.org/taxpower](http://www.actionaid.org/taxpower)

## ► Endnotes

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