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## Article

# Taxpayers Seek Strategies to Avoid Wealth Tax

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*Suggested Citation:* Brühlhart, Marius; Schmidheiny, Kurt (2018) : Taxpayers Seek Strategies to Avoid Wealth Tax, ifo DICE Report, ISSN 2511-7823, ifo Institut - Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 16, Iss. 2, pp. 19-21

This Version is available at:

<https://hdl.handle.net/10419/181276>

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## Marius Brülhart and Kurt Schmidheiny Taxpayers Seek Strategies to Avoid Wealth Tax<sup>1</sup>

Did you know that Switzerland is world champion in wealth taxation? Although its wealth tax accounts for just 3.5% of public revenues, Switzerland clearly leads the pack of OECD countries (see Table 1).<sup>2</sup> Switzerland also pretty much bucks the international trend when it comes to this form of taxation, as many industrialised nations – including Germany, Italy and Austria – have abolished the wealth tax in recent decades.

Bucking the general trend along with Switzerland, academics have also rediscovered the wealth tax in recent years. In view of rising income and wealth inequality in most countries, and an ever-growing gap between the “one percent” and the rest of the population, the French economist Thomas Piketty made a prominent plea for higher wealth taxes (Piketty 2014). He advocated a “Holy Trinity” of wealth taxation, consisting of wealth, inheritance and taxes on capital income (Piketty, Saez and Zucman 2013). The latter is not levied in Switzerland.

A central criterion in the evaluation of most types of taxation is how and to what extent they influence taxpayers’ behaviour. Simply put, a tax is less desirable if taxpayers react more sensitively (“elastically”) to it.

<sup>1</sup> This article is a translated version of the article “Steuerzahler suchen bei Vermögenssteuer nach Ausweichstrategien”, published in „Die Volkswirtschaft“, 2017.

<sup>2</sup> Wealth tax is only levied by the cantons and municipalities. The Swiss federal government has not taxed private wealth since 1959.

Table 1

Wealth Tax Revenues in Selected OECD Countries

	1995	2000	2005	2010	2015
Switzerland	2.87	3.10	3.40	3.42	3.62
Luxembourg	1.59	1.77	1.45	1.39	2.00
Norway	1.31	1.09	1.02	1.12	1.01
Iceland	1.16	0.00	0.00	0.00	0.00
The Netherlands	0.54	0.50	0.02	0.01	0.00
Spain	0.44	0.55	0.42	0.03	0.32
Sweden	0.41	0.69	0.36	0.00	0.00
Germany	0.26	0.03	0.01	0.00	0.00
France	0.25	0.38	0.40	0.53	0.52
Italy	0.21	0.00	0.00	0.00	0.00
Denmark	0.19	0.00	0.00	0.00	0.00
Finland	0.08	0.28	0.18	0.00	0.00
Austria	0.06	0.00	0.00	0.00	0.00
Greece	0.05	0.00	0.00	0.00	0.00

Note: As a percentage of total tax revenues. The table only features those OECD countries with a wealth tax in 1995.  
Source: OECD Revenue Statistics.

Moreover, a particular type of tax is more damaging the more “real” such reactions are, meaning that they affect economic output rather than being only of an accounting nature. In a recent study using Swiss data we examine the reactions triggered by a wealth tax using the Swiss empirical laboratory (Brülhart, Gruber, Krapf and Schmidheiny 2017).

### HIGH TAX ELASTICITY OF PRIVATE WEALTH

Our main objective is to estimate how strongly declared private wealth reacts to changes in the wealth tax burden. To this end, we draw on detailed data on taxable wealth and tax rates in the cantons and municipalities.<sup>3</sup> At the cantonal level, we use aggregated data from all cantons for the years 2003 to 2012. At the municipal level, we analyse individual administrative data for taxpayers in the canton of Bern for 2001 to 2011.

The evaluations with both datasets lead to similar estimates: an increase in the wealth tax rate by one tenth of a percent, whether this be at the cantonal or municipal level, reduces the amount of declared wealth by around 3%. This implies that the tax elasticity of wealth is at least twice as large as that of personal income.<sup>4</sup> In other words, wealth reacts more sensitively to taxes. Our estimates also exceed the wealth tax elasticities of other studies, which is presumably due to the higher quality of the data available to us (panel data) (Seim 2017; Zoutman 2015).

### AVOIDANCE VERSUS REAL RESPONSES

Through what mechanism does wealth react to differences in taxation? This question is similarly important to assessing wealth taxation as the size of the reaction itself. Responses to changed taxation are most serious

for a canton or municipality when they are of a “real” nature. This is the case if people work less or move away due to higher wealth taxes. If reactions are of a purely “accounting” nature, however, wealth taxes may reduce taxable income, but do not effectively lower economic output. Such avoidance strategies could take the form of transfers into tax-free vehicles, gifts or simple non-disclosure.

Individual data from the canton of Bern reveal no signs that the large estimated wealth

<sup>3</sup> The research described here was financed by the Swiss National Fund (see [fiscaldefederalism.ch](http://fiscaldefederalism.ch)). The canton of Bern granted access to anonymised individual data.

<sup>4</sup> Elasticity used in this comparison: “net-of-tax-rate elasticity with respect to wealth returns.”



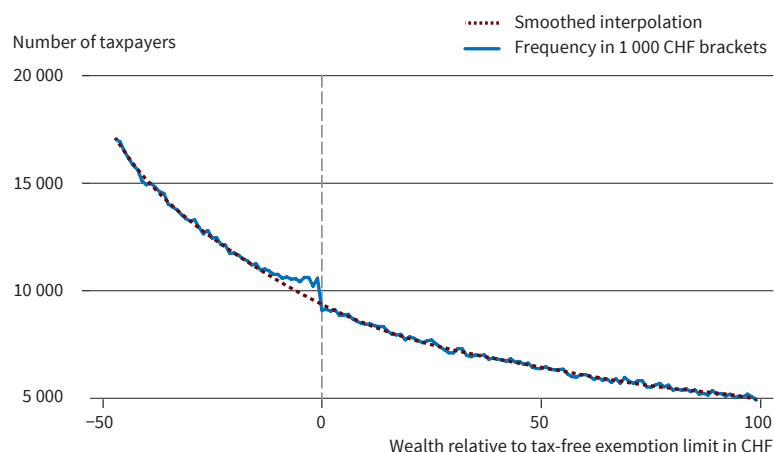
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Figure 1

## Number of Taxpayers and Wealth Relative to Tax-Free Exemption Limit



Source: Brülhart, Gruber, Krapf and Schmidheiny (2017).

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elasticities are caused by wealthy taxpayers changing residence in search of low wealth taxes. In view of the small area covered by the canton of Bern, this is strong result. It suggests that there may be limited scope for local-level tax competition in the area of wealth tax. However, during the time period in question, there were only minimal changes in the wealth tax rates in the municipalities of Bern. Far bigger changes between Swiss cantons could very well have prompted individuals to change their place of residence. Unfortunately, we currently avail of no data allowing us to observe such movements at the between-canton level.

We furthermore observe that declared *income* reacts relatively weakly to wealth tax differences in the data. Since the lion's share of income in Switzerland is wage income, this means that wealth taxes do not exert any major influence over the real labour supply. Declared *real estate wealth* also reacts relatively weakly to wealth taxes.

Large elasticities in total wealth, by contrast, primarily stem from strong reactions to financial assets, in the short term at least, which account for 43% of total assets in our data.

Our statistics also clearly reveal a “bunching” of wealth just below the tax-free exemption limit: wealth levels that are just below the tax-free exemption limit are declared far more often than the overall distribution would lead one to expect (see Figure 1).<sup>5</sup> Some taxpayers consequently seem to target a taxable income that is just below the tax exemption limit.

Overall, this evidence suggests that the tax sensitivity of declared wealth is based more heavily on consumer decisions and accounting optimisation than on real adjustments in behaviour. Such optimisation is possible, for example, via transfers between corporate and private assets, through payments into tax-free

pension plans, or the mere non-declaration of assets. However, a robust estimate of the relative weighting of the various types of reaction is beyond the scope of our available data.

## WEALTH VERSUS INHERITANCE TAX

Private wealth is also subject to inheritance tax. It is occasionally suggested that the tax burden should be transferred from wealth tax to inheritance tax.<sup>6</sup> Such suggestions are based on the assumption that the wealth tax limits the incentives to

work and to save more heavily than the inheritance tax. Indeed, while the wealth tax has to be paid by savers annually, the inheritance tax is only levied once in a generation, and is paid not by savers themselves, but by their heirs.

A previous study showed that the inheritance tax triggers no statistically significant migration of older, wealthier taxpayers between cantons (Brülhart and Paret 2014). It therefore seems that neither the inheritance nor the wealth tax exert a major influence over the location decisions of private households in Switzerland.

Our recent study also analyses how the inheritance tax – in addition to wealth and income taxation – impacts on private wealth declared in a given canton (Brülhart et al. 2017). Unlike the earlier study mentioned above, we do find statistically significant effects. This suggests that although inheritance taxes do not have any statistically recognisable effects on the residential choices across cantons, they do influence the volume of assets declared. Indeed, we find that declared wealth reacts at least as strongly to inheritance taxes as it does to wealth taxes.

So, should the tax burden be shifted from annual wealth to bequests? Both types of tax hardly seem to trigger any real reactions, and the avoidance reactions through accounting optimisation and adjustments in consumption seem to be of similar magnitude. However, we do not yet know much on precise response mechanisms. It is for instance conceivable that individuals would try to avoid inheritance tax more strongly through inter vivos gifts, while they respond to taxes in private wealth by retaining earnings in closely held corporations. Such differences would be relevant for the economic assessment of both types of tax, but we know little about this as yet from empirical research.

<sup>5</sup> In the canton of Bern assets worth below 92,000 to 97,000 Swiss francs were not taxed during the period under examination (the threshold value changed over time).

<sup>6</sup> For example, Salvi and Zobrist (2013).

## AVOIDANCE STRATEGIES PREVAIL

To summarise, the total volume of declared wealth reacts sensitively to changes in the wealth tax burden. According to the "Ramsey rule" of optimal taxation one should thus consider transferring the tax burden from wealth to income, the latter representing a less elastic tax base.

However, in addition to the sensitivity to taxes, it is also important to consider the manner in which taxpayers react to taxes. Do they adjust their labour supply, change their place of residence or seek to avoid tax on the same income via optimised accounting, consumption and transfer decisions? Our estimates indicate that pure avoidance reactions, rather than "real" responses in terms of labour supply or residential choice, tend to prevail for both inheritance and wealth taxes. If correct, then our relatively large wealth tax elasticities are more an expression of generous avoidance opportunities than of performance-reducing incentives.

However, our findings on types of behavioural responses are based on data that are either relatively aggregated or somewhat lacking in identifying variation. A more detailed empirical analysis would require more precise and comprehensive data, ideally in the form of merged individual-level tax data covering several cantons.

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