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**Working Paper**

## Wealth tax: perspectives in a post-pandemic world

Policy in Focus, No. 49

**Provided in Cooperation with:**

International Policy Centre for Inclusive Growth (IPC-IG)

*Suggested Citation:* de Carvalho Junior, Pedro Humberto Bruno (Ed.); Soares, Fabio Veras (Ed.) (2021) : Wealth tax: perspectives in a post-pandemic world, Policy in Focus, No. 49, International Policy Centre for Inclusive Growth (IPC-IG), Brasilia

This Version is available at:

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# Policy in Focus

A publication of  
The International Policy Centre for Inclusive Growth

Volume 18, Issue No. 3 • December 2021

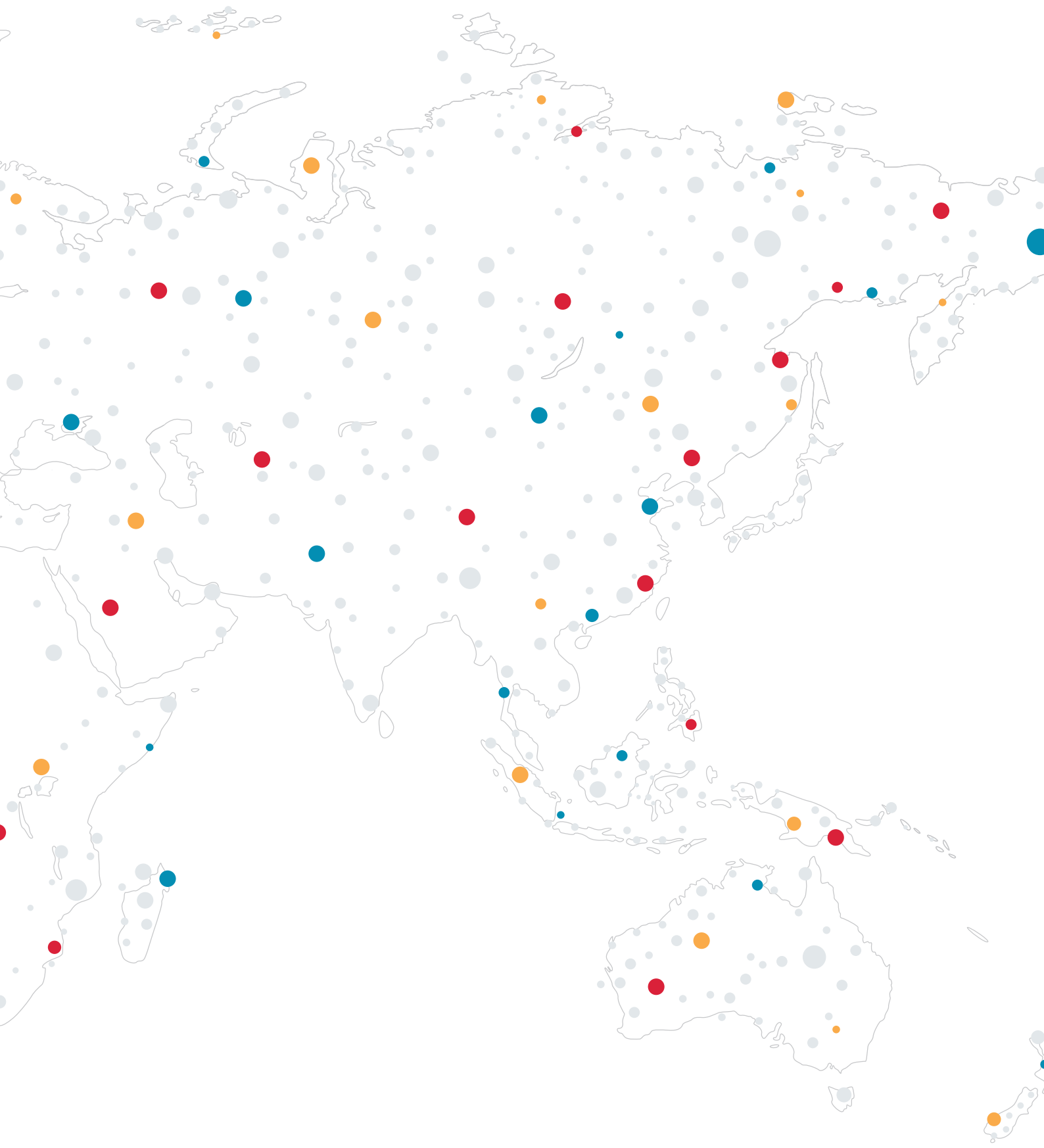


Wealth tax: Perspectives  
in a post-pandemic world

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# Policy in Focus



Published by the International Policy Centre  
for Inclusive Growth (IPC-IG)

Policy in Focus, Volume No. 19, Issue No. 3, December 2021

**Wealth tax: Perspectives in a post-pandemic world**

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**Acknowledgements:** The Editors would like to express their sincere  
appreciation to all the authors for their generous and insightful  
contributions, without which this issue simply would not have  
been possible.

ISSN: 2318-8995

# Summary

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# Editorial

Many studies have shown that wealth inequality is even greater than income inequality and has increased in recent decades. This occurs in part because personal wealth is much more unequally distributed than income, and many households do not have any (or even negative) wealth. In the absence of capital taxation, wealth concentration tends to increase and self-reinforce, since the top richest can save more, diversify investments, and transfer wealth through untaxed inheritances.

Even in the current global scenario of growing inequality, net wealth taxes are far less widespread than they used to be. While 12 countries in Europe had net wealth taxes in 1990, only Norway, Switzerland and Spain still have a broad-based wealth tax. Three South American countries also levy wealth taxes: Argentina, Uruguay and Colombia. The main justification for the abolishment of net wealth taxes during the 1990s was their high administrative costs versus low revenue collection. However, studies have shown that their tax design failed to reach the top richest people, proposing more progressive wealth taxation and third-party reporting to curb tax evasion. More recently, some countries have been discussing the (re)introduction of net wealth taxes to raise revenues and reduce wealth inequality, especially in light of the COVID-19 pandemic, which has greatly exacerbated these indicators.

This issue of Policy in Focus is dedicated to wealth taxes, presenting deep debates on whether they can be an effective instrument for distributive and fiscal policies to promote a more inclusive recovery in a post-pandemic world. Its nine articles are subdivided into four parts.

The opening article discusses wealth taxation in the United States. Emmanuel Saez and Gabriel Zucman explore the wealth tax proposals focused on the super-rich, while in their following piece Janet Holtzblatt

debates effective instruments for the better taxation of capital in the country. The second part addresses wealth taxation in Europe. Sarah Perret debates the reasons why wealth taxes failed in the past and how they could be effective today. Subsequently, Alexander Krenek and Margit Schratzenstaller highlight the importance of policies that curb tax avoidance and estimate the revenue potential of wealth taxes in various EU countries. Marius Brühlhart et al. study the tax base elasticity and other central challenges of the well-established Swiss wealth tax system. The third part of the magazine tackles the wealth tax debate in three emerging economies: Brazil, India and South Africa. Pedro Humberto Carvalho Junior and Marc Morgan propose a formula for the implementation of a tax on large fortunes in Brazil, which is already provided for in the Constitution. Sakti Golder provides a perspective of India's inequality, and defends a more intensive use of different taxes on capital to fund social expenses. Aroop Chatterjee, Léo Czajka and Amory Gethin, using combined microdata from household surveys, income tax, and macroeconomic balance sheets, found an extremely high concentration of wealth in South Africa and estimate the revenue potential of a wealth tax. The fourth and final section provides a perspective of wealth taxes against the COVID-19 health crisis: Khaled Abdelkader and Ruud De Mooij discuss progressive tax reform to fund social spending and drive inclusive economic recovery.

We hope that these articles contribute to the deepening debate on the feasibility of wealth taxes, providing a fresh perspective for a post-pandemic world.

Happy reading!

*Pedro Humberto Bruno de Carvalho Junior*

# Progressive wealth taxation<sup>1</sup>

*Emmanuel Saez<sup>2</sup> and Gabriel Zucman<sup>2</sup>*

Income and wealth inequality have increased dramatically in the United States over the last decades (Piketty and Saez 2003; Saez and Zucman 2016; Piketty, Saez, and Zucman 2018). A long-standing concern with wealth concentration is its effect on democratic institutions and policymaking.<sup>3</sup>

The view that excessive wealth concentration corrodes the social contract has deep roots in America—a country founded in part in reaction against the highly unequal, aristocratic Europe of the eighteenth century. Before 1776, the northern American colonies already taxed wealth, including financial assets and other personal property, instead of land only as in England (Saez and Zucman 2019a).

In the first part of the 20th century, the United States invented very progressive income and estate taxation, combined with heavy corporate taxation.<sup>4</sup> This led to a large and sustained reduction in income and wealth concentration that reversed after tax progressivity went away (Saez and Zucman 2019a). There is a renewed political demand to use progressive taxation to curb the rise of inequality and raise revenue. A wealth tax is a potentially more powerful tool than income, estate, or corporate taxes to address the issue of wealth concentration as it goes after the stock rather than the flow.

Two major U.S. presidential candidates proposed wealth taxes in 2019. In January 2019, Elizabeth Warren proposed a progressive wealth tax on families or individuals with net worth above USD50 million with a 2 per cent marginal tax rate (3 per cent above USD1 billion). In September 2019, Bernie Sanders proposed a similar wealth tax starting at USD32 million with a 1 per cent rate and with substantially more progressivity within the billionaire class (with marginal tax rates growing from 5 per cent for billionaires up to 8 per cent for decabillionaires). Such a tax would impose a much heavier burden on billionaires than all existing income, estate, and corporate taxes combined (Saez and Zucman 2019a). The key difference

relative to earlier proposals or existing wealth taxes in other countries is the high exemption thresholds proposed. Less than 0.1 per cent of U.S. families would be liable for the Warren or Sanders wealth tax (Saez and Zucman 2019b, 2019c). The United States has never implemented a progressive wealth tax before, but other countries have. What do economists have to say about the merits and demerits of wealth taxation and how it compares with other tax tools?

In this article we discuss the role a wealth tax can play in the overall progressivity of the U.S. tax system. A well-enforced wealth tax would be a powerful tool to restore progressivity at the top of the U.S. income and wealth distribution. It would increase the tax rate of wealthy families who can currently escape progressive income taxation by realising little income relative to their true economic income. Despite the rise of inequality, the U.S. tax system has become less progressive in recent decades. The three traditional progressive taxes—the individual income tax, the corporate income tax, and the estate tax—have weakened. The top marginal federal income tax rate has fallen dramatically, from 70 per cent or more between 1936 and 1980 down to 37 per cent in 2018. Corporate taxes (which are progressive in the sense that they tax corporate profits, a highly concentrated source of income) as a share of corporate profits have declined from about 50 per cent in the 1950s and 1960s to 16 per cent in 2018 (Saez and Zucman 2019a). Estate taxes on large bequests now raise little revenue due to a high exemption threshold, many deductions, and weak enforcement. As a result, when combining all taxes at all levels of government, the U.S. tax system now resembles a giant flat tax. All groups of the population pay rates close to the macroeconomic tax rate of 28 per cent, with a mild progressivity up to the top 0.1 per cent and a significant drop at the top end, with effective tax rates of 23 per cent for the top four hundred richest Americans (Saez and Zucman 2019a, chapter 1). In addition, we discuss the real economic effects of wealth taxes on wealth inequality.

## Role in overall tax progressivity

Wealth taxes are very progressive because net wealth is more concentrated than income. Wealth taxes are more progressive than property taxes because property taxes are only levied on real estate, which is more equitably distributed than net wealth (Saez and Zucman 2016). Wealth taxes also more closely track ability to pay than property taxes because they allow people to deduct debts. The progressivity of a wealth tax depends on how high the exemption threshold is and on whether a graduated rate schedule is applied among taxpayers.

Saez and Zucman (2019a) estimate effective tax rates (including all taxes at the federal, state, and local levels) by income groups using the data developed by Piketty, Saez, and Zucman (2018). We can use the same data on the joint distribution of income and wealth to estimate the effect of the wealth tax on the overall progressivity of the current U.S. tax system.

One justification for a wealth tax is to increase the effective tax rate on the very wealthiest Americans who may not realise much income and hence may pay low effective tax rates today. Indeed, the two wealth tax proposals by Warren and Sanders target specifically billionaires (and multibillionaires) with higher rates.

The top of the Forbes 400 list includes founder-owners of large companies (Amazon's Jeff Bezos, Microsoft's Bill Gates,<sup>5</sup> Berkshire Hathaway's Warren Buffett, and Facebook's Mark Zuckerberg). Of these four companies, only Microsoft pays dividends. As long as Bezos, Buffett, and Zuckerberg do not sell their stock, their realised income is going to be minuscule relative to their wealth and true economic income. For example, Buffett disclosed that his fiscal income—defined as adjusted gross income reported on his individual income tax return—is in the tens of millions. Since his wealth is in the tens of billions, the realized return on his wealth is on the order of 0.1 per cent. Bezos's, Buffett's, Zuckerberg's, and Gates' companies are also multinational companies which can book a substantial



share of their profits in tax havens to reduce their corporate income tax (Zucman 2015).

How much the top four hundred wealthiest Americans report in fiscal income—and hence pay in income taxes—is a central question for the desirability of a wealth tax. Absent direct evidence on the income taxes paid by the Forbes 400, we need to triangulate using various sources. We use three sources which turn out to provide consistent results. Table 1 summarises the computations.

First, the IRS provides statistics on linked estate and income tax data. Bourne et al. (2018) study the link between wealth on the estate tax return for 2007 decedents and fiscal income over the last five years preceding death (2002–6). In the highest wealth category they consider—USD100 million and above—reported capital income (averaged over 2002–6 and expressed in 2007 dollars) is 3 per cent of 2007 wealth (ibid.). In national and financial accounts, the ratio of aggregate capital income in 2002–6 to aggregate wealth in 2007 is 5.9 per cent. This suggests that reported capital income of the wealthiest decedents is only 51 per cent of their true income (assuming conservatively that the wealthy obtain a return on their wealth equal to the aggregate return). One objection is that the wealthy may avoid realising capital gains towards the end of their life, since unrealized capital gains benefit from the step-up of basis at death. Bourne et al. (2018), however, show that realised capital gains are very large in their sample—on average 45 per cent of capital income.

Second, the SCF provides information on the joint distribution of wealth in year  $t$  and reported income in  $t - 1$ . In 2016, the ratio of reported income to wealth was 3.2 per cent for the top 0.001 per cent wealthiest Americans (wealth above USD650 million, 86 records in the public SCF) and 3.2 per cent for the top 0.01 per cent (wealth above USD 190 million, 465 records). This 3.2 per cent rate of return is only 50 per cent of the 6.4 per cent aggregate capital income-to-wealth ratio in 2016. Earlier waves of the SCF provide similar results, which is reassuring given the small sample sizes. These SCF results are very similar to the IRS linked estate and income tax results and not subject

**TABLE 1:** Reported income relative to true income for top wealth holders

	Estates above USD100 million (linked to income tax) (1)	SCF top .001 per cent wealth holders (2)	SCF top .001 per cent wealth holders (3)	Forbes 400 (combined with IRS top 400) (4)
Year	2007	2016	2016	2014
Wealth (\$ millions)	313	951	365	5,725
Reported income (USD millions)	9.4	30.5	11.6	159
Reported income/wealth	3.0%	3.2%	3.2%	2.8%
Average macro return on wealth	5.9%	6.4%	6.4%	6.8%
<b>Percentage true income reported</b>	51%	50%	50%	41%
Sample size	116	86	465	400

Notes: Column (1) uses data from Bourne et al. (2018). The source in columns (2) and (3) is the 2016 Survey of Consumer Finances (SCF household unit). Column (4) combines the Forbes Top 400 with the IRS top 400 highest income earners.

Source: Authors' elaboration.

to the issue that realised capital income might be particularly low within a few years before death.

Third, the IRS provides statistics on the top four hundred highest earners, a group we call the 'IRS top 400'. In 2014, the latest year available, the IRS top 400 had an average fiscal income of 318 million. The Forbes 400 wealthiest have, by definition, less fiscal income than this on average. How much less? To address this question, we relate the fiscal income of top income earners to the fiscal income of top wealth holders in the SCF. In the 2016 SCF, the top 0.001 per cent income earners (sample of 64) reported fiscal incomes that were 6.7 per cent of the wealth of the top 0.001 per cent wealth holders. This is approximately twice the income of the top 0.001 per cent wealth holders mentioned above. Averaged across all SCF years from 1998 to 2016, this ratio is 2.3 on average. This result shows that there is indeed substantial re-ranking in wealth versus reported income. Based on this finding, we estimate that the Forbes 400 wealthiest Americans have a reported income of USD159 million (USD318 million divided by the ratio of 2). In 2014, the average wealth of the Forbes 400 was USD5.725 billion. So the fiscal income of the Forbes 400 was 2.77 per cent of their wealth (2.77 per cent  $\times$  USD5.725 billion = USD159 million), which is only 41 per cent of the 6.77 per cent economy-wide return

on wealth in 2014. If we make the conservative assumption that the return on wealth for the Forbes 400 is the same as the economy-wide return, fiscal income for the Forbes 400 is only 41 per cent of their true economic income.

In sum, using three different sources and methodologies, we find that top wealth holders have a fiscal income that is about or slightly less than half of their true economic income (defined as wealth times the average macroeconomic return to wealth). In what follows, we assume that the Forbes 400 have a ratio of fiscal income to true economic income of 45 per cent; population-wide, this ratio is around 70 per cent (Piketty, Saez, and Zucman 2018). The super wealthy do not realize as much income as the average person, but on average they realise substantially more than what Warren Buffett publicly disclosed.

Naturally, our 45 per cent estimate of reported income relative to full economic income is based on triangulating the best available sources, and it could be refined in future work. We have applied this 45 per cent ratio to estimate taxes paid by the top four hundred retrospectively to all years since 1950 in Saez and Zucman (2019a). We are fully aware that this triangulation is an approximation, but it is the best approximation we could create using public sources. Given the importance

of the policy question—How much do billionaires really pay in taxes?—we view it as important to mobilise internal data to provide better estimates.

Figure 1 depicts the average tax rate by income groups in 2018, the year following the passage of the Tax Cuts and Jobs Act. All federal, state, and local taxes are included. Taxes are expressed as a fraction of pre-tax income, a comprehensive measure of income before government taxes and transfers (other than Social Security) that add up to total national income (Piketty, Saez, and Zucman 2018). P0-10 denotes the bottom 10 per cent of adults, P10-20 the next 10 per cent, and so on. The economy-wide average tax rate is 28 per cent. Tax rates in the bottom seven deciles are slightly lower than average (25 per cent instead of 28 per cent). Tax rates between percentiles 80 and 99.9 are very slightly higher than average (around 29 per cent). The tax rate peaks at 33 per cent for P99.9-99.99 (that is, the bottom 90 per cent of the top 0.1 per cent). The tax rate then falls above P99.99 and is lowest for the top four hundred at 23 per cent. Taking all taxes together, the U.S. tax system looks like a giant flat tax with similar tax rates across income groups but with lower tax rates for billionaires.

A wealth tax such as the one proposed by Elizabeth Warren would have a large

impact on progressivity within the top 0.1 per cent. To illustrate this point, we use the capitalised income wealth estimates and assume that the wealthy would hide 15 per cent of their wealth. The tax rate on the top 0.1 per cent excluding the top 0.01 per cent would increase modestly by 4 points. The tax rate in the top 0.01 per cent would rise by 14 points. Among the top four hundred, the tax rate would double from 23 per cent to 46 per cent. A wealth tax with a high exemption threshold (USD50 million) and a marginal tax rate of 2 per cent (3 per cent above USD1 billion) would have a major impact on progressivity. It would restore tax progressivity at the top to levels last observed in 1980 (Saez and Zucman 2019a).

### Effects on wealth inequality

A well-enforced wealth tax would reduce wealth concentration. The reason is simple: if the rich have to pay a percentage of their wealth in taxes each year, it makes it harder for them to maintain or grow their wealth. Changes in consumption versus saving can exacerbate this effect. With a wealth tax, wealthy taxpayers may decide to spend more today and save less (this is the substitution effect: consuming now rather than later becomes relatively cheaper). Changes in consumption versus saving could conversely dampen this effect if the wealthy decide to spend less to preserve their wealth (this is the wealth effect, as

the wealth tax reduces economic resources of the taxpayer). In any case, the wealth of people subject to the tax is expected to rise more slowly after the introduction of the wealth tax than before. There is relatively little empirical work evaluating whether a progressive wealth tax can reduce wealth concentration. One recent exception is Jakobsen and others (2019), who exploit compelling identification variation with the Danish wealth tax and find that the long run elasticity of wealth with respect to the net-of-tax return is sizeable at the top of the distribution.

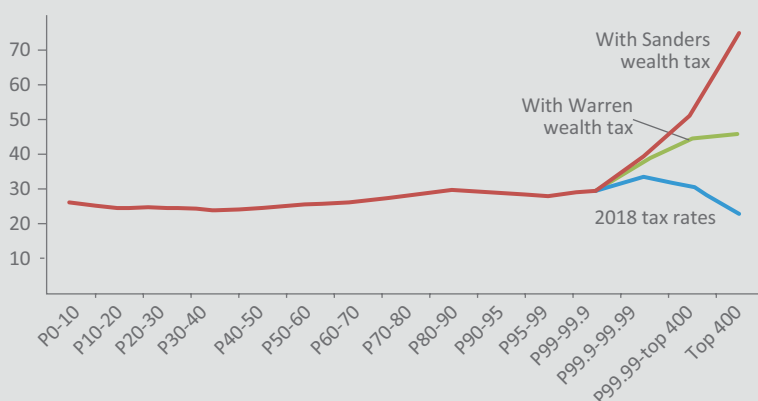
### Conclusion

What can we conclude from our analysis about the prospects for progressive wealth taxation in the United States?

First, the wealth tax is likely to be the most direct and powerful tool to restore tax progressivity at the very top of the distribution. The greatest injustice of the U.S. tax system today is its regressivity at the very top: billionaires in the top four hundred pay less (relative to their true economic incomes) than the middle class. This regressivity is the consequence of the erosion of the corporate and estate taxes and the fact that the richest can escape the income tax by reporting only half of their true economic incomes on their individual income tax returns. A wealth tax with a high exemption threshold specifically targets the richest and could resolve this injustice.

Second, our analysis shows that the wealth tax has great revenue- and wealth-equalising potential in the U.S. context. Household wealth has grown very large in aggregate (five times annual national income in 2018), and the rich own a growing fraction of it (around 20 per cent is owned by the top 0.1 per cent of families). The wealth tax, if the tax rates are high enough, is also a powerful tool to deconcentrate wealth. Wealth among the Forbes 400 has grown about 4.5 per centage points faster annually than average since 1982. A wealth tax of 2 or 3 per cent per year can put a significant dent in this growth rate advantage. With successful enforcement, a wealth tax must either deliver revenue or deconcentrate wealth.<sup>6</sup> Set the rates low (1 per cent) and you get revenue in perpetuity but little (or very slow) deconcentration. Set the rates medium

**FIGURE 1:** The effects of wealth taxation on overall tax progressivity



Notes: The figure depicts how adding the wealth taxes proposed by Elizabeth Warren and Bernie Sanders would affect the progressivity of the overall tax system. The Warren wealth tax has a 2 per cent marginal tax rate above USD50 million and a 3 per cent marginal tax rate above USD1 billion; the Sanders wealth tax has a 1 per cent marginal tax rate above USD32 million, 2 per cent above USD50 million, 3 per cent above 250 million, 4 per cent above USD500 million, 5 per cent above USD1 billion, 6 per cent above USD2.5 billion, 7 per cent above USD5 billion, 8 per cent above USD 10 billion.

Source: Saez and Zucman (2019) updated from Piketty, Saez, and Zucman (2018).

“ Progressive wealth taxes are fragile and susceptible to being undermined.



Photo: Teresa Alexander-Arab. *Lifestyles of the rich on Palm Island, Miami, USA, 2013* <[is.gd/MmnCQc](https://is.gd/MmnCQc)>.

(2–3 per cent) and you get revenue for a long time and deconcentration eventually. Set the rates high (significantly above 3 per cent) and you get deconcentration quickly, but revenue does not last long. Which is best depends on one’s objectives.

Can a wealth tax be successfully enforced? Our review of past and foreign experiences in addition to recent empirical work tells us that enforcement is a policy choice. We certainly have plenty of evidence showing that a poorly designed wealth tax generates a lot of avoidance and little revenue. But we have also learned lessons about how to design a wealth tax well. First, cracking down on offshore tax evasion, as the United States has started doing with the Foreign Account Tax Compliance Act (FATCA),<sup>7</sup> is crucial. Second, taxing expatriates, as the United States currently does, is also very important to prevent the mobile wealthy from avoiding the tax. Third, systematic reporting of wealth balances (instead of relying on self-assessments as for the estate tax) is a necessary condition for good enforcement, as the income tax amply demonstrates. Finally, the issue of valuation of closely held businesses is key for the integrity of the wealth tax. Our view is that the government must create the currently missing (or highly private) markets for equity of large closely-held businesses. It is often the case that accounting rules develop in synergy with the tax system.

As a caveat, it is important to note that progressive wealth taxes are fragile and

susceptible to being undermined. The left could undermine its political support by lowering the exemption threshold too much and creating hardship for the illiquid merely rich. The right could then undermine its effectiveness by providing exemptions (and hence loopholes) for certain asset classes or by imposing tax limitations based on income. ●

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1. This article is an adapted version of a Brookings Institution paper (Saez and Zucman 2019d).
2. University of California, Berkeley.
3. Political contributions, for example, are extremely concentrated with 0.01 per cent of the population accounting for over a quarter of all contributions (Drutman 2013).
4. The United States was the first country—in 1917, four years after the creation of the income tax—to impose top marginal tax rates as high as 67 per cent on the highest incomes. It was also the first country, starting in the 1930s, to impose high top tax rates (of 70 per cent or more) on wealth at death. No European country ever imposed similarly high top inheritance tax rates (Scheve and Stasavage 2016).
5. Bill Gates left Microsoft in 2020.
6. If neither materialises, it means that enforcement is not successful, or we learn that, in contrast to what all the data sources tell us, U.S. wealth is equally distributed.
7. A 2010 U.S. federal law requiring all non-U.S. foreign financial institutions to search their records for customers with indicia of a connection to the U.S., including indications in records of birth or prior residency in the U.S., and to report their assets and identities to the Department of the Treasury.



# Taxing wealth in the United States: Issues and challenges<sup>1</sup>

Janet Holtzblatt<sup>2</sup>

In the United States, as in many countries, wealth inequality has grown over the past several decades. Federal Reserve Board economists estimate that the share of net wealth owned by the wealthiest 1 per cent of families grew from 25 per cent in 1989 to 33 per cent in 2019 (Bricker, Goodman, Moore, and Henriques-Volz 2021). The COVID-19 pandemic, with its widely disparate effects across the U.S. population, has most likely accentuated that trend and also left large fiscal debts in its wake. By the end of fiscal year 2021, the federal debt held by the public was 99.7 per cent of gross domestic product (GDP), according to the Congressional Budget Office (CBO 2021).

The growth in both wealth inequality and government debt has spurred politicians to seek out policies that would reverse those trends. During the 2020 presidential campaign, Senators Bernie Sanders and Elizabeth Warren proposed wealth taxes on nearly all the holdings of the very wealthy. But unique features of the U.S. tax system, economy, and the Constitution would likely impede passage and implementation of a wealth tax in the United States. Other policymakers—most notably, President Joe Biden—favor alternative approaches that build on the current tax system.

## Why are wealth taxes appealing?

For many people, wealth taxes are appealing for two simple reasons: They have the potential to raise a considerable amount of revenue and would be owed by relatively few people, who have the resources to pay the tax.

Senator Sanders's proposal illustrates the potential impact of a wealth tax. In his plan, all net wealth would be taxed, with rates increasing from 1 per cent on net wealth above USD32 million to 8 per cent above USD10 billion (half those wealth thresholds for single taxpayers). The Tax Policy Center estimates his proposal would raise USD2.2 trillion (0.8 per cent of GDP) over a decade (Holtzblatt and Zwiefel 2021). Over 97 per

cent of the wealth tax would be borne by households in the top 0.1 per cent of the wealth distribution. These estimates do not reflect the pandemic's impact on the amount and distribution of wealth.

## How would a wealth tax affect marginal tax rates?

In the United States, some types of assets are already taxed at the national and subnational level. Property taxes—usually imposed only on real estate—are the largest source of revenues for local governments (Urban-Brookings Tax Policy Center 2021). At the national level, estate and gift taxes are imposed on transfers of wealth, though a high threshold—USD11.7 million in 2021—ensures that relatively few estates are subject to the tax.

Taxes on capital income are much more common at the national level in the United States. The tax treatment of capital income varies significantly, depending on the asset and the amount of time held by the taxpayer. For example:

- Interest income and short-term capital gains (from the sale of assets held for less than a year) are generally taxed at the same rate as most other forms of income, such as wages and salaries.
- Lower tax rates are applied to long-term capital gains and most dividends.
- Higher-income taxpayers pay an additional 3.8 per cent surtax on most capital income.
- Some capital gains from the sale of home are excluded from taxable income.

This variation results in complexity and can distort investment decisions.

Consider, for example, two wealthy taxpayers—Fran, who is a risk lover and invests her portfolio in stocks yielding a 10 per cent rate of return, and Maxwell, who is risk averse and earns 2 per cent on

his holdings in interest-bearing accounts. Under current law, Fran's tax rate on her capital income would range from zero (if she earned no dividends and did not sell her stock) to 23.8 per cent (if she received dividends and had capital gains realisations). Maxwell, on the other hand, would be subject to a tax rate of 40.8 per cent on his interest income.

Now add a 1 per cent wealth tax to the mix. For risk-loving Fran, the impact of a 1 per cent wealth tax would be equivalent to a 10 per cent tax on her dividend income. With Maxwell's interest-bearing accounts, a 1 per cent wealth tax translates into a 50 per cent tax on his interest income. In combination with the current U.S. income tax, Fran's and Maxwell's marginal tax rates on capital income would increase to as high as 33.8 per cent and 90.8 per cent, respectively.

Still, a wealth tax would offset a weakness of the current U.S. income tax. Currently, capital gains can escape taxation completely. During the owner's lifetime, the tax is deferred until the asset is sold. If the owner holds on to the asset until death, the basis is reset at the current market value. Thus, heirs will not pay taxes on any capital gains that accrued between the time the original owner bought the asset and their death. Because the wealth tax is based on accruals rather than realisations, that 'escape hatch' would be closed.

## How would businesses be taxed?

Broad-based taxes are generally favoured by tax analysts because they do not create distortions or opportunities for tax avoidance and evasion. A broad-based wealth tax would apply to all types of assets, including bank accounts, real estate, stock, privately held businesses, pensions, yachts, vehicles, jewellery, and art.

Yet, countries with wealth taxes have generally exempted some types of assets from the base. Some assets are excluded because they are viewed as addressing a social or economic policy goal; others

may be excluded because of valuation challenges or liquidity constraints. And some are exempted because of the high administrative costs of verifying ownership. For many of those reasons, some countries, which later repealed their wealth taxes, exempted certain privately held businesses or applied lower tax rates to their values. (OECD 2018).

In the United States, privately held businesses are a large share of the very wealthy's investment portfolio. In 2019, the gross value of privately held businesses represented about 22 per cent of net wealth. About one-third of the gross value of privately held businesses was held by families with over USD50 million in assets (roughly the top 0.1 per cent of families on the net wealth distribution), and over half of their investment portfolio was held in those businesses (Author's calculations based on the Survey of Consumer Finances 2020).

Still, the inclusion of privately held businesses in a U.S. wealth tax base would face some of the same challenges experienced by other countries.

**Ownership.** In the United States, income from non-corporate businesses (such as partnerships) is not taxed at the entity level. Instead, the income is passed through to each owner, who is taxed on their share. Although the partnership reports each owner's share of the profits to the Internal Revenue Service (IRS), determining the identity of the individual who owns a share of the business can be unwieldy—especially when partnerships own partnerships (Cooper et al. 2015). That challenge to the individual income tax would likely carry over to a wealth tax as well.

**Role of owner.** Owners vary in terms of their participation in a business, and some countries that later repealed their wealth taxes treated owners who were substantially involved in the management of their enterprises more favourably than passive owners (OECD 2018). The U.S. individual income tax system already differentiates between active and passive participants in noncorporate businesses, but the rules are complicated and often lead to complex avoidance strategies to categorise the owner's activity in the most tax beneficial manner.



Photo: Franco Folini. Homeless woman with dogs, San Francisco, California, 2006 <[is.gd/wmTgWa](https://www.flickr.com/photos/francofolini/5211111111/)>.

Similar carve-outs for a wealth tax would add another layer of incentives to the characterisation of an owner's participation in the business.

**Debt.** The tax base is generally net wealth, which would encourage taxpayers to take on more debt to lower the wealth tax. That would reinforce an incentive already in the income tax to take on debt to reduce taxable income with deductible interest on loans, rather than draw upon the business's earnings.

**Valuation.** The market value of privately held businesses is difficult to determine, especially for the many entities that are rarely—if ever—sold. At a Tax Policy Center conference in 2019, Beth Shapiro Kaufman—an expert in estate and gift taxes—concluded: “appraisals are just appraisals, and they're basically all wrong” (Curry 2019). Formula valuations are less burdensome than comprehensive annual appraisals and are already used for some other tax provisions (such as estate taxes and property taxes), but they are often successfully disputed by wealthy taxpayers who have the resources to challenge the tax authorities (Civic Consulting Alliance 2018).

#### **Can the Internal Revenue Service administer a wealth tax?**

The treatment of privately held businesses is just one challenge that would face the IRS if tasked with implementing a wealth tax. Others include addressing complicated strategies that would shift wealth (at least

on paper) through trusts, gifts, intra-family transfers, taxpayer-controlled foundations, and transfers of funds overseas.

Administrative hurdles are one of the top reasons why many countries narrow or repeal their wealth taxes (OECD 2018). In the United States, those administrative challenges would be reinforced by the current weakened state of the IRS. After a decade of deep budget cuts, the IRS is struggling to administer the current tax system even as Congress regularly expands its responsibilities. A steep reduction in audit rates—especially among high-income taxpayers—is just one manifestation of those budget cuts (Holtzblatt 2021).

#### **Is a wealth tax constitutional?**

Ultimately, the fate of a wealth tax in the United States may be decided by the Supreme Court. The U.S. constitution bans direct taxes that are not collected evenly across states based on their populations. The definition of a direct tax, however, has long been debated by constitutional scholars.

Some scholars argue a wealth tax would be unconstitutional, citing an 1895 case—*Pollock v. Farmers' Loan and Trust*—in which the Supreme Court ruled that an income tax was a direct tax. Others argue that case law support a much narrower definition of a direct tax. For example, in 1900, the Supreme Court decided in *Knowlton v. Moore* that an inheritance tax on property was not a direct tax (Rosalsky 2019).

But should a wealth tax be enacted and then struck down by the Supreme Court, it could still prevail. In 1913, an income tax was enacted following the adoption of the Sixteenth Amendment to the Constitution.<sup>3</sup> However, amending the Constitution requires the approval of two-thirds of both houses of Congress and ratification by three-quarters of the states—an unlikely event in the current, deeply divided, political environment.

### What are the alternatives to a wealth tax?

Despite the attention in the 2020 campaign, a wealth tax is currently not on President Biden or Congressional leaders' agenda. But policymakers continue to explore more incremental ways to reduce the preferential treatment of capital income and raise revenues. Senator Ron Wyden, the Democratic chair of the Senate Finance Committee, for example, has proposed a mark-to-market system, in which the change in the value of financial assets would be taxed each year. The value of nonfinancial assets would be taxed when sold—thus avoiding the valuation challenges—but a 'lookback' rule, such as an interest charge, would reduce the benefits of tax deferral (Wyden 2019).

Although a mark-to-market tax is, by design, based on capital income, Wyden added a wealth threshold to his proposal during the Congressional consideration of tax legislation in 2021. Under his revised proposal, the mark-to-market tax on gains would only apply to people with more than USD1 billion in assets or USD100 million in annual income for three consecutive years.

During the 2020 campaign, President Biden included an array of other proposals that, combined with income thresholds, were targeted at wealthy taxpayers but implemented through the existing income and estate taxes. They included:

- increasing the top tax rate on capital gains to equal the top rate on other forms of income;
- repealing step-up basis and taxing accrued capital gains when the taxpayer dies;
- increasing the estate tax rate; and
- lowering the threshold at which the estate tax applies.

All but the changes to the estate tax were included in the President's budget submission for Fiscal Year 2022—yielding USD322 billion over the next decade assuming passage of the President's proposal to increase the top individual income tax rate (U.S. Department of the Treasury 2021). The campaign proposals to expand the estate tax would raise an additional USD218 billion, according to the Tax Policy Center (Mermin et al 2020).

By building on the current tax system, those changes could be more rapidly implemented than a new tax and would be constitutional—a clear advantage over a wealth tax. Moreover, they would reduce the variation in the tax treatment of capital income among different asset types and would likely lead to more efficient investments. The trade-off, however, is that the incremental reforms may raise much less revenue and reduce wealth inequality more slowly than a broad-base wealth tax, such as those proposed by Senators Sanders and Warren. ●

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1. The statements made and the views expressed are those of the author and should not be attributed to the Urban-Brookings Tax Policy Center, the Urban Institute, the Brookings Institution, their trustees, or their funders. Funders do not determine research findings or the insights and recommendations of our experts. Further information on Urban's funding principles is available at <<https://www.urban.org/about-us/our-funding/funding-principles>>; further information on Brookings' donor guidelines is available at <<https://www.brookings.edu/donor-guidelines/>>. The author wishes to thank Robert McClelland for helpful comments and suggestions.

2. Senior Fellow, Urban-Brookings Tax Policy Center.

3. "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."



# Wealth taxes: Past experiences and future role?<sup>1</sup>

Sarah Perret<sup>2</sup>

The debate around wealth taxes has resurfaced in light of increasing inequality and in response to the COVID-19 crisis. Income inequality is high; wealth inequality is even higher. There is also some evidence that inequality has increased in recent decades, and the COVID-19 crisis is expected to further widen income and wealth gaps (OECD 2021a; 2021b). At the same time, governments will need more revenue to finance their response to the pandemic. The crisis is thus prompting reflection on the need to raise revenue in ways that may be compatible with inequality reduction objectives. In this context, wealth taxes are increasingly being considered as an option and some countries have already started introducing tax increases on the wealthiest households (OECD 2021c).

## Past experiences with wealth taxes

Wealth taxes are not a new instrument. In 1990, there were a dozen OECD countries that levied individual net wealth taxes, defined as recurrent taxes on individual net wealth (OECD 2018a). While their design has varied across countries, wealth taxes are levied annually on a wide range of immovable and movable assets, net of debt.

However, most of these wealth taxes raised very little revenue and have been repealed since. Generally, in countries where they were levied, wealth taxes accounted for less than 1 per cent of total tax revenues. Switzerland has been an exception, raising around 4 per cent of its total tax revenues from wealth taxes (OECD 2018a). Today, there are only four OECD countries that still levy annual wealth taxes: Colombia, Norway, Spain, and Switzerland.

A major pitfall of previous wealth taxes was that many assets benefitted from exemptions and reliefs, which increased complexity and reduced revenues and progressivity. Exemptions and reliefs were particularly common for pension assets, business assets, primary residences, and artwork (OECD 2018a). Some of these exemptions were granted to reduce

valuation costs for hard-to-value assets (e.g., artwork) or aimed to guarantee fairness and reduce liquidity issues (e.g., primary residences). The exemption for business assets was intended to avoid discouraging entrepreneurship. Other exemptions and reliefs were simply the result of successful lobbying. Overall, however, the consequence was that the revenues collected from these taxes were often very limited. In addition, exemptions and reliefs made wealth taxes more difficult to administer and effectively reduced progressivity because they tended to provide greater benefits to individuals with higher levels of wealth.

Another difficulty with past wealth taxes was that they were typically levied on relatively low or moderate levels of wealth. For instance, before repealing its wealth tax in 2018, France had the highest tax exemption threshold, whereby individuals and households with a net wealth above EUR1.3 million were subject to the tax. Other countries had far lower thresholds, meaning that wealth taxes were levied not just on the very rich but also on part of the middle class (OECD 2018a). When a wealth tax is levied on the middle class, it can have regressive effects because a wealth tax is levied regardless of the returns that are generated by households' assets. This penalises those who hold assets that generate low returns, who tend to be less wealthy individuals and households. Wealth taxes levied on moderate levels of wealth also increased the risks of taxing households with illiquid wealth and little income to pay the tax.

The functioning of wealth taxes has also been complicated by difficulties that are more inherent to annual wealth taxation, such as the need to value assets regularly. This can be particularly challenging for certain types of assets, such as shares in non-listed or closely held businesses, artwork and intellectual property. Indeed, for these assets, there are no readily available property values and valuation may involve the use of complex methods. The difficulty lies not only in valuing these assets, but also in updating their values on a regular basis.

Difficulties in tracking wealth also made wealth taxes less effective. It used to be relatively easy to evade wealth taxes by hiding assets offshore and never reporting them to tax authorities. There is evidence that these types of offshoring practices were not only occurring but were heavily concentrated among the wealthiest taxpayers (Alstadsæter et al. 2019). This made wealth taxes less effective and allowed some of the wealthiest households to minimise their wealth tax liabilities, often leaving households with moderate levels of wealth to pay the greatest proportion of these taxes.

In addition to these administrative difficulties, the main economic arguments against wealth taxes were that they discouraged savings and investment and encouraged taxpayer flight, but the empirical evidence is limited. Empirical studies have generally found that wealth taxes had limited effects on savings, and stronger effects on wealth reporting, tax avoidance and evasion (e.g., Brülhart et al. 2020; Durán-Cabré et al. 2019). These limited effects on savings may partly reflect the fact that wealth taxes could simply be avoided or evaded and therefore did not significantly deter savings and wealth accumulation. There is also limited evidence confirming the fear that wealth taxes encouraged rich individuals to leave their country. There is some anecdotal evidence of this phenomenon, but the very few empirical studies that have found evidence of such migration effects focused on countries with regional wealth taxes (Brülhart et al. 2021; Agrawal, Foremny and Martínez-Toledano 2021), where migration is easier. Despite limited available evidence, these fears were widespread and these economic arguments were widely used to justify the repeal of wealth taxes (Perret 2021).

## Could wealth taxes play a role today?

In a context of increasing inequality and greater tax transparency, governments could revisit the role and design of taxes levied on personal capital income and assets. The context has evolved: in addition to higher inequality levels, governments are better equipped to tax wealth and



Photo: UNICEF Ethiopia/Nahom Tesfaye. Women selling vegetables in the Saris market, Addis Ababa, Ethiopia, 2020 <is.gd/LNU8l4>.

“ Wealth taxes are one possible way of addressing wealth inequality.

capital income than they used to be. The progress made on international tax transparency has made it much more difficult for individuals to evade taxes by hiding their assets offshore. In particular, significant progress has been made through the Automatic Exchange of Information (AEOI) between tax authorities, which requires information on financial accounts held by non-residents to be automatically exchanged every year with the jurisdictions where the account holders are tax resident. Digitalisation is also increasing tax administrations' access to data and their ability to handle large amounts of information, which could ultimately strengthen their capacity to tax personal capital income and assets.

Wealth taxes are one possible way of addressing wealth inequality, but there are other available tax tools that countries often do not utilise to their full potential. Given some of the practical challenges involved in levying annual wealth taxes, as discussed above, and the uncertainty around the economic effects of a broad-based wealth tax, there might be merit in prioritising reforms that strengthen existing taxes to raise revenue and narrow wealth gaps, in particular taxes on personal capital income (dividends, interest and capital gains) and inheritance and gift taxes. Indeed, a combination of well-designed taxes on personal capital income and wealth transfers can go a long way towards ensuring that the wealthiest households pay a fairer share of tax (OECD 2021d).

In particular, there is significant room to enhance the design of taxes on personal capital income. For instance, in many countries, dividends and capital gains are taxed at lower rates than labour income. Given that these types of income are heavily concentrated at the top of the distribution, the fact that they are taxed at lower rates reduces the effective tax burden on the wealthiest households. It can also encourage taxpayers who have their own companies to shift part of their remuneration for highly taxed labour income to lower taxed capital income. There is indeed significant evidence of such income shifting behaviours (Miller, Pope and Smith 2019; Cooper et al. 2015). The tax treatment of household savings also varies widely across asset types and the assets typically held by less wealthy households tend to be taxed more heavily than other assets (OECD 2018b). This highlights that there is significant room to reform taxes on personal capital income, limit tax arbitrage opportunities, and enhance the effective progressivity of personal income taxes.

A recent OECD study shows similar findings in relation to inheritance and gift taxes (OECD 2021d). These taxes are meant to play an important role in reducing wealth inequality and enhancing equality of opportunity, yet the way they are designed allows, at least in some countries, the wealthiest households to pay lower effective tax rates than other households. This is mainly because

certain types of assets that tend to be concentrated in the hands of the wealthiest households benefit from exemptions and reliefs. Therefore, the design of existing inheritance and gift taxes could be improved, particularly by reducing the preferential treatment granted to certain assets and by limiting tax avoidance opportunities.

However, where strengthening taxes on personal capital income and wealth transfers is not feasible or insufficient to narrow wealth gaps, there may be more justification for a wealth tax. In that case, a wealth tax would have to be designed and implemented in ways that avoid the pitfalls of previous attempts. That would require limiting tax exemptions and reliefs for different types of assets. Wealth taxes could also apply to higher levels of wealth to minimise administrative and compliance costs and limit potential liquidity issues. Tail provisions (e.g., where individuals moving to another country would remain subject to the tax for a period of time), measures to reduce valuation costs (e.g., keeping valuations for certain assets fixed for a few years) and provisions to prevent liquidity risks (e.g., allowing payments in instalments and deferrals) could also be considered. Some challenges associated with levying annual wealth taxes would likely remain, however, including the need to regularly value assets. Instead of annual wealth taxes, countries could also examine the merits and challenges of one-off wealth taxes.

It is important to stress that the most appropriate instruments to address inequality will depend on the country. Country-specific factors that should be considered to determine the most appropriate policy mix include, for instance, the level of inequality and the government's administrative capacity. In developing countries, particularly where tax administrations have limited resources, the implementation of a wealth tax might be difficult. A first step could instead involve improving the design and functioning of immovable property taxes. Indeed, in some developing countries, immovable property is the tax base that best reflects individuals' capacity to contribute (Chambas, Brun and Rota-Graziosi 2007). These taxes could be made progressive or include a surtax for high-value immovable property. Taxes on luxury consumption might also be a way to ensure that those who are better off contribute more. Enhancing the design and functioning of personal income tax systems, in combination with efforts to encourage formalisation, could also play a key role.

Finally, there is no silver bullet, and a combination of different policy instruments will be needed to successfully reduce income and wealth gaps. A combination of tax instruments will be needed to address inequality. In addition, expenditure policies—especially direct transfers—will be critical as they tend to play a much larger role in reducing income inequality than taxes, at least in

OECD countries (Causa and Hermansen 2017). Thus, investing in ways to improve direct transfers should be a priority. Finally, policies beyond tax and spending reforms, including competition policy or education reform, for example, will be needed to address some of the root causes of inequality. ●

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1. This contribution builds on OECD (2018a). The additional opinions expressed and arguments employed herein are those of the author and do not necessarily reflect the official views of the OECD or of its member countries
2. Organisation for Economic Co-operation and Development (OECD).

“ A combination of different policy instruments will be needed to successfully reduce income and wealth gaps.



Photo: European Union/Olympia de Maismont. Children getting back to school, Burkina Faso, 2021 <[is.gd/LNU814](https://is.gd/LNU814)>.



# A European net wealth tax<sup>1</sup>

Alexander Krenek<sup>2</sup> and  
Margit Schratzenstaller<sup>2</sup>

Although the taxation of wealth has a longer tradition and history in tax practice compared to personal income and corporate taxes, and despite vigorous debates in the political arena, it has traditionally attracted surprisingly little attention in the public finance and taxation literature. Only in the last decade, against a background of substantial and increasing global wealth inequality (Zucman 2019), which is exceeding income inequality in most industrialised countries (Brys et al. 2016), the debate on the taxation of top incomes and wealth has gained momentum (see, for example, Kopczuk 2013; Iara 2015; Bastani and Waldenström 2018; OECD 2018). Most recently, with expectations that the COVID-19 crisis will exacerbate inequalities worldwide, there are calls to strengthen tax progressivity, such as through higher taxes for the wealthy (e.g., IMF 2021). Particularly, there is renewed interest in the taxation of net wealth, which is carried out only in very few countries worldwide.

A common objection against a net wealth tax is the fear that mobile capital cannot be taxed effectively in open economies, as tax subjects relocate their assets or their residence to avoid the tax (Kleven et al. 2020). The growing cross-border mobility of financial assets and the rise of tax havens, facilitated by the emergence of information and communications technology and the elimination of formal barriers to cross-border capital transfers (such as capital controls), have been rendering the effective enforcement of net wealth taxes increasingly difficult. This is one of the main reasons why, in the past, most economists and international organisations (see, for example, IMF 2011) advocated against the introduction of net wealth taxes or recommended their substitution by taxes on less mobile wealth, particularly by a property tax on real estate.

These recommendations rest on a rather narrow empirical base. The extent and consequences of international net wealth tax competition are an under-

researched issue. In the last years, a few authors have tried to identify the impact of net wealth taxes on real economic activity (such as wealth accumulation and entrepreneurship) on the one hand, and on taxable—i.e., reported—wealth on the other. It is still a matter of dispute in the literature whether a net wealth tax primarily affects real economic decisions or merely reduces reported wealth due to tax avoidance and/or evasion (Brülhart et al. 2017). The Sweden study by Seim (2017) suggests that about one-third of the elasticities of taxable wealth is caused by under-reporting of asset values, and that taxpayers respond by tax evasion and avoidance rather than by adjusting their savings. Similarly, Jakobsen et al. (2020) show that the Danish wealth tax had a small impact on overall wealth accumulation. For the Swiss canton Lucerne, Brülhart et al. (2019) find that about 50 per cent of the aggregate response of taxpayers to a wealth tax cut is related to tax evasion.

Studies disentangling the various tax avoidance channels via which reported wealth is reduced are missing. Existing empirical evidence on the responsiveness of reported wealth does not allow to identify and quantify international capital flight as a distinct tax avoidance/evasion channel. There are practically no econometric analyses directly addressing the question of whether net wealth taxes lead to outflows of mobile capital. Empirical evidence regarding the effect of wealth taxation on offshore tax evasion is scarce (see Advani and Tarrant 2020).

However, there are two types of evidence for some impact of wealth taxation on the relocation of assets or taxpayers' residence. First, recent estimations suggest that considerable amounts of private wealth are hidden in tax havens; a central motivation is obviously to escape taxation (see, e.g., Zucman 2014; Johannesen and Zucman 2014; Alstadsæter et al. 2018). The very wealthy tend to hide their wealth offshore, as demonstrated by Alstadsæter, Johannesen and Zucman (2019) for Scandinavia and by Londoño-Vélez and Ávila-Mahecha (2021) for Colombia.

Second, several case studies corroborate the theoretical expectation that wealth taxes cause (illicit) offshore transfers of assets. For example, after Sweden's abandonment of all foreign exchange controls in 1989, an outflow of large fortunes to tax havens such as Switzerland or Luxembourg could be observed, providing strong motivation for the government to discontinue the net wealth tax in 2007 (Henrekson and Du Rietz 2014). Pichet (2007) found a considerable volume of capital flight out of France since the introduction of the French net wealth tax. Londoño-Vélez and Ávila-Mahecha (2021), in turn, identified considerable amounts of wealth tax evasion through offshore transfers.

Analyses by Brülhart et al. (2017; 2019) for Switzerland provide some support for the plausible assumption that the effect of net wealth taxes on reported wealth is more pronounced the more integrated the regions involved are. In a recent paper, Brülhart et al. (2021) identify significant taxpayer mobility across Swiss cantons regarding the net wealth tax. Similarly, Agrawal, Foremny and Martínez-Toledano (2020) show migratory responses by wealthy taxpayers within Spain after the re-introduction of the wealth tax in 2011. However, this recent evidence for Switzerland and Spain refers to intra-national location decisions only. Reviewing the small body of empirical work, Perret (2020) concludes that the evidence of the impact of wealth taxes on locational decisions is slim and mostly anecdotal.

We consider that the existing empirical results do not contradict our assumption that the reactions of tax subjects make it increasingly difficult to enforce a tax on net wealth in a purely national context. Responses by taxpayers probably take the form of manipulations of reported wealth via various channels, including hiding wealth abroad in low- or no-tax jurisdictions rather than moving taxpayers' locations abroad. Although there is no systematic and elaborated empirical evidence on international net wealth tax competition, the development

“ Ireland and Italy eliminated their net wealth taxes only a few years after their implementation.



Photo: Radu Micu. City of Matera, Italy, 2015 <is.gd/LNU814>.

of wealth taxation in Europe during the last few decades lends some support to the hypothesis that a ‘race-to-the-bottom’ type of tax competition based on international mobility, especially of financial assets, has contributed to the almost complete disappearance of net wealth taxes.

Between 1990 and 2018, the share of net wealth taxes in overall revenues from wealth-based taxation declined from 14.6 per cent to 11.4 per cent in the EU15,<sup>3</sup> from almost 18 per cent to 13 per cent in the 17 Euro countries in the Organisation for Economic Co-operation and Development (OECD), and from 14.6 per cent to 9.9 per cent in those EU countries for which OECD data are available. In the early 20th century, several of the now EU member states and other European countries had introduced a net wealth tax or transformed a formerly existing one into a net wealth tax with modern design. Almost all of these countries have abolished their net wealth taxes since the early 1990s.<sup>4</sup> Among the last EU Member States to discontinue their net wealth taxes were Finland (2006) and Sweden (2007): both countries held on for longer than most, as a compensation for the regressive dual income tax introduced in the early 1990s (Messere et al. 2003).

Only very few countries adopted net wealth taxes as late as in the last quarter of the past century. Of these, Ireland and Italy eliminated their net wealth taxes only a few years after their implementation.

Iceland and Spain re-introduced a net wealth tax temporarily in 2010 and 2011, respectively, as a fiscal consolidation measure after experiencing severe budget problems in the aftermath of the financial crisis. France drastically narrowed the tax base in 2018, now taxing only real estate and exempting all other assets due to fear of tax flight. Overall, there are more European countries that have never levied a net wealth tax than those that ever did or are still doing so.

The tax base elasticities and low mobility of taxpayers found in the existing empirical studies suggest that at least part of this specific downward tax competition in the realm of net wealth taxes may be—following Brüllhart and Parchet (2014)—characterised as ‘alleged’ tax competition. However, in combination with the still extensive options to make use of tax havens worldwide to hide wealth from domestic tax authorities (Zucman 2014), this tax competition (whether alleged or indeed existing) restricts the options for countries to effectively tax capital (Bastani and Waldenström 2018). However, as Cremer and Pestieau (2011) point out, this argument (which is valid at least for financial assets) should not lead to the conclusion that the tax should be eliminated, but rather calls for strengthening international cooperation. Such cooperation can take several forms, which may reinforce each other. One approach is to strengthen instruments restricting the possibilities for tax evasion through hiding wealth offshore,

in particular exchange of information on request and automatic exchange of information, for which the OECD and G20 have recently developed international standards. Another approach is to implement an internationally coordinated or harmonised net wealth tax. Remarkably, only a few proposals for an internationally-coordinated approach to adopt a net wealth tax can be found in the literature, including Piketty’s (2014) concept of a progressive global wealth tax and the recent proposals by Landais et al. (2020) and Kapeller et al. (2021) for a European net wealth tax to fund the European response to COVID-19.

Against this background, we estimated the potential revenues of an EU-wide net wealth tax (Krenek and Schratzenstaller 2018).

The general lack of administrative wealth data, as well as the unknown behavioural response to the introduction of a European net wealth tax are key challenges for credibly estimating the potential revenues of such an instrument. The effects of the ongoing COVID-19 pandemic, as well as the fiscal and monetary responses to it, increase the level of uncertainty. Our approach is based on Vermeulen’s adjustment (Vermeulen 2014 and 2016) of the Household Finance and Consumption survey (HFCS), conducted by the European Central Bank (ECB) every three years. This survey—the best source of household-level wealth data for Euro countries—has two distinct



Photo: Sergei Gushev. Kuala Lumpur, Malaysia, 2019 <[is.gd/pqHYsE](https://is.gd/pqHYsE)>.

shortcomings: differential non-reporting (i.e., non-reporting is positively correlated with wealth) and under-reporting of wealth (i.e., aggregate wealth for a given country in the survey is considerably lower compared to the aggregates displayed in the national financial balance sheets). For example, compared to the national balance sheets, up to 88 per cent of financial wealth is missing in the second wave of the HFCS. This gap is not closed by simply adjusting the top tail of the wealth distribution.

Following Vermeulen (ibid.), we use the strong empirical evidence that wealth at the top of the distribution follows a Pareto distribution. Thus, we deal with differential non-reporting by including observations from rich lists into the sample as a first step, and by estimating the shape coefficients of the respective Pareto distributions in a second step. Finally, we introduce weights for the relevant types of assets so that after the Pareto adjustment, the totals of the survey match the totals of the national balance sheets. We thus create a synthetic wealth distribution for every HFCS country.

Considering the potentially significant behavioural responses to a European net wealth tax we use the elasticities estimated by Brülhart et al. (2017) in the Swiss context. Even though the external validity of this study is questionable, the authors' finding that an increase of 1 percentage point in the tax rate on net wealth decreases the tax base by 35 per cent

appears to be an enormous but plausible effect, making our revenue estimates rather conservative.

We propose a tax design similar to the one suggested by Piketty (2014), applying a simple progressive tax schedule with two tax rates: 1 per cent for net wealth above EUR1 million and 1.5 per cent for net wealth above EUR5 million.<sup>5</sup>

For the 20 EU Member States which are included in the second wave of the HFCS, the potential revenues of our proposed net wealth tax are EUR156.2 billion, or 1.47 per cent of total GDP, while affecting only 4.8 per cent of households and resulting in an effective tax rate of about 0.3 per cent of net wealth. These estimations suggest that, given the highly unequal distribution of wealth, fears that a net wealth tax would necessarily have to affect a substantial share of households to yield sizeable revenues are unsubstantiated, if top wealth holders are considered properly. ●

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1. This paper is a shortened version of Krenek and Schratzenstaller (2018). We are grateful to Andrea Sutrich for her careful research assistance.
  2. Austrian Institute of Economic Research.
  3. Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the UK.
  4. The only exceptions are Switzerland, Norway, and Luxembourg (for corporations).
  5. As HFCS data on net wealth refer to households, the proposed net wealth tax is levied on a household basis. Therefore, tax exemptions also pertain to the household level.

“With expectations that the COVID-19 crisis will exacerbate inequalities worldwide, there are calls to strengthen tax progressivity, such as through higher taxes for the wealthy.



Photo: UN Women/Allison Joyce. Rohingya woman in refugee camp, 2018 <[is.gd/RtWntW](https://is.gd/RtWntW)>.

# Wealth taxation: The Swiss experience<sup>1</sup>

Marius Brühlhart,<sup>2</sup> Jonathan Gruber,<sup>3</sup>  
Matthias Krapf,<sup>4</sup> Kurt Schmidheiny<sup>4</sup>

Rising capital shares of income and associated increases in inequality observed in many developed nations have spurred new interest in the taxation of wealth. Piketty, Saez and Zucman (2013) have proposed the adoption of an ‘ideal’ combination of taxes on capital, covering annual net worth in addition to capital income and bequests. Wealth taxes have also regained popularity in policy circles in the United States, Germany and France. Wealth taxes are a topic of growing academic interest in developing nations as well (Londoño-Vélez and Ávila-Mahecha (2019; 2021)).

## The elasticity of the wealth tax base

Arguments for and against wealth taxes invariably turn to behavioural responses. As a first approximation, the stronger behavioural responses are to a tax, the greater its likely distortionary effects. The tax will also be ‘leakier’ and thus raise less revenue. The elasticity of the wealth tax base is therefore a crucial policy parameter.

While taxpayer reactions to more common forms of taxation have been studied in

considerable depth, behavioural responses to wealth taxes have only recently come into the focus of academic research.<sup>5</sup>

The comparative neglect of wealth taxes has likely been due to their waning importance. Only four Organisation for Economic Co-operation and Development (OECD) nations still levy a wealth tax that covers real estate as well as financial wealth: Colombia, Norway, Spain, and Switzerland.<sup>6</sup> The withering of the wealth tax has deprived researchers of both a motive and empirical settings for investigating effects of wealth taxes.

Resurging policy interest in wealth taxation, however, has stimulated a wave of empirical work on the topic. Researchers have exploited individual-level data in countries that either still levy wealth taxes or have abolished them not too long ago. The main object of these studies is to estimate the semi-elasticity of taxable wealth with respect to a one-percentage-point change in the wealth tax.

Researchers have followed two empirical approaches. One approach is to analyse bunching of reported wealth at discontinuities in tax schedules (Seim 2017; Londoño-Vélez and Ávila-Mahecha

2019). This approach yields small elasticity estimates but likely underestimates behavioural responses, since changes in wealth depend, to a significant extent, on asset prices that are uncertain and exogenously determined. Other researchers have therefore used difference-in-differences analysis of changes in wealth tax schedules, comparing taxpayers who are affected differently by these changes for reasons that are arguably unrelated to their subsequent responses (Zoutman 2018; Jakobsen et al. 2020; Durán-Cabré et al. 2019). These studies find responses that are an order of magnitude larger than the bunching-based analyses, with semi-elasticities ranging from 14 per cent to 32 per cent. Saez and Zucman (2019a) have interpreted this literature as implying a representative semi-elasticity of 8 per cent, which they employed for scoring U.S. presidential candidate Elizabeth Warren’s wealth tax proposal.

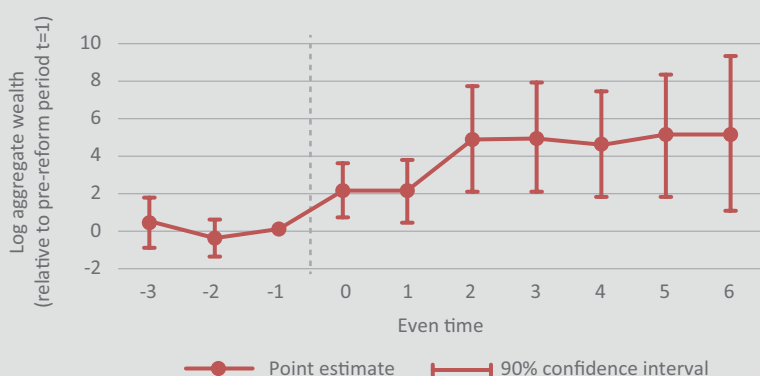
## Elastic wealth in Switzerland

The main current user of wealth taxes, and therefore in some respects the most propitious laboratory for studying their effects, is Switzerland. Swiss wealth taxes account for 3.9 per cent of its tax revenue, by far the highest level among OECD countries. Switzerland is different also because its wealth tax schedules have very low exemption thresholds in international comparison, and because wealth taxes are raised at the cantonal (district) and municipal levels, with no federal wealth tax.

This leads to sizeable intra-national variation across jurisdictions and over time. A recent study (Brühlhart et al. 2021), examines taxable wealth by canton over the period 2003-2015. Since this was a period of multiple canton-level tax reforms, the study was able to track aggregate responses of wealth holdings to rich longitudinal variation in wealth tax levels.

We find that reported wealth holdings in Switzerland are very responsive to wealth taxation. Figure 1 shows how log taxable wealth in a canton evolves in response to a drop in the wealth tax rate. According to our central estimate, a 1 percentage-point drop in the top wealth tax rate raises reported wealth by 43 to 51 per cent over a

**FIGURE 1:** Cumulative response of taxable wealth to a decrease in the wealth tax

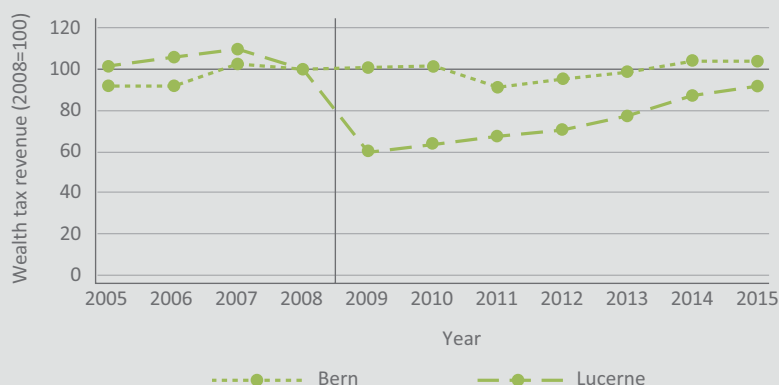


Note: Distributed-lag cumulative effects estimated through a first-differences panel model on canton-year data. Effects can be interpreted as the percentage response of aggregate taxable wealth to a 1 percentage-point reduction in the canton wealth tax rate.

Source: Authors’ elaboration.

“ Cumulative wealth growth in Lucerne was almost identical to the one in Bern before the 2009 tax cut.

**FIGURE 2: Wealth tax revenue: Lucerne vs Bern**



Notes: The figure shows annual wealth tax revenues in Lucerne and Bern, scaled relative to 2008 values (set at 100). Revenue aggregated from individual tax records.

Source: Authors' elaboration.

five-year horizon. This estimate is identified by all tax changes in the data, many of which are small. When we focus on the largest canton-level tax reforms, we find even larger semi-elasticities.

Moreover, the richness of the Swiss institutional setting allows us to dissect the aggregate responses. To that end, we have analysed individual-level tax records from two cantons: Lucerne and Bern. We exploit the fact that Lucerne cut its statutory wealth tax rates by half in 2009, whereas Bern only adopted a modest reform. The difference between the two cantons' policies can be considered quasi-random, as it hinged on a marginal decision against a larger reform in Bern, made possible by a direct-democratic instrument that exists in Bern but not in Lucerne. We show that cumulative wealth growth in Lucerne was almost identical to the one in Bern before the 2009 tax cut. After the tax cut, however, wealth growth in Lucerne clearly exceeded wealth growth in Bern. By 2015, cumulative wealth growth in Lucerne exceeded wealth growth in Bern by 34 per cent. Nearly a quarter of this excess wealth growth is accounted for by net-inmovers into Lucerne, and about a quarter of this moving margin is due to international moves. Some of these moves could have been due to taxpayers optimising between primary and secondary residences, but since Lucerne is not a typical canton for second residences,

the large majority of fiscally relevant moves probably corresponded to real taxpayer moves. Moreover, housing wealth, which accounts for some 40 per cent of private wealth in the Swiss data, is taxed by the canton where the property is located, irrespective of the fiscal residence of the owner.

In further analyses, we decompose the remainder of the aggregate response as follows: some 20 per cent can be attributed to capitalisation into housing prices, up to 6 per cent of the response can be attributed to increased savings (including a mechanical effect of lower wealth taxation), and some 50 per cent can be attributed to changes in taxable financial assets of immobile taxpayers.

#### Different settings, different elasticities

Our research suggests that wealth taxes are leakier in Switzerland than elsewhere, for two plausible reasons. First, Swiss cantons are small. This facilitates taxpayer mobility. We find that some 25 per cent of the aggregate response to changed wealth taxation is due to taxpayer mobility. Another 20 per cent of the response is due to capitalisation into housing prices—an indirect effect of mobility.

Second, tax enforcement in Switzerland is comparatively lax, especially given that financial wealth is self-reported. About 50 per cent of the aggregate responses are due to changes in reported financial assets

of non-movers. Complementary evidence does not suggest that this effect can be attributed to changed savings or earnings.

At first glance, up to 85 per cent of the large responses of taxable wealth observed in Swiss cantons could therefore be the result of the cantons' small size and of lax enforcement. If we reduce our estimated responses by 85 per cent, we obtain elasticities that are—if anything—lower than those found elsewhere. Therefore, Saez and Zucman's (2019a) assumed semi-elasticity of 8 per cent for scoring a U.S. wealth tax turns out to be consistent with our estimates.

We do not know, however, whether the avoidance options available in Switzerland mitigate 'real' responses through savings and labour supply. To some extent, avoidance could act as a substitute for real responses.

#### Did wealth tax cuts in Swiss cantons pay for themselves?

In light of the large observed behavioural responses, it is interesting to consider the revenue implications of wealth tax changes. Estimations with our canton-level panel from 2003 to 2015 show that the medium-term elasticity of tax revenue with respect to the tax rate is somewhere between -0.27 and -0.36: far from the -1 which would be needed for Laffer effects.<sup>7</sup> Hence, raising wealth tax rates still increases wealth tax revenues.





Photo: UN Photo/Jean-Marc Ferré. An aerial view of Geneva, Switzerland, 2010 <[is.gd/LNU814](https://is.gd/LNU814)>.

“ The main current user of wealth taxes, and therefore in some respects the most propitious laboratory for studying their effects, is Switzerland.

We also studied the revenue implications of the Lucerne tax cut, for which we had found a particularly large behavioural response. Figure 2 shows the resulting evolution of wealth tax receipts in Lucerne and Bern. We observe an immediate drop in Lucerne after it lowered its wealth tax rate. In subsequent years, the drop in the tax rate was followed by a steady increase in declared wealth which mitigated the loss of tax receipts. By 2015, declared wealth had increased by 34 per cent relative to 2009, but Lucerne’s wealth tax revenues remained below their pre-reform level. Even the strong aggregate tax-base response was not strong enough for the tax cut to yield Laffer effects in terms of the wealth tax itself, six years after the reform. ●

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1. This article is based on Brühlhart et al. (2019).
2. Université de Lausanne.
3. Massachusetts Institute of Technology (MIT).
4. Universität Basel.
5. For a survey of research on behavioural responses to income taxation, see Saez, Slemrod and Giertz (2012).
6. The OECD’s Global Revenue Statistics Database in addition lists Argentina and Uruguay as countries that levy wealth taxes (data for 2019, see: <[https://stats.oecd.org/Index.aspx?DataSetCode=RS\\_GBL](https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL)>).
7. A ‘Laffer effect’ denotes a situation where the tax base reacts so strongly to the tax burden that a tax cut leads to an increase in tax revenue.

# A net wealth tax for Brazil: Main lessons and international perspectives<sup>1</sup>

*Pedro H. B. Carvalho Junior<sup>2</sup>  
and Marc Morgan<sup>3</sup>*

The distributive function of taxation is becoming increasingly relevant in a context of rising income and wealth inequality across much of the world (Alvaredo et al. 2018). In this article, we consider an important component of a progressive tax system: the taxation of wealth. By 'net wealth taxation' we consider taxes on the net value of the aggregate wealth of an individual—typically immovable property, such as real estate (residential and commercial properties), and movable property, such as financial assets (equities, bonds etc.).

But why tax wealth in the first place? There are multiple reasons, which have to do with the nature of wealth and its implications in a market economy with private property. First, much of private wealth is collectively determined, making it difficult to distinguish individual contributions to its monetary value. Second, an important part of wealth is due to circumstances. In the first case, we can think about the effects of various central bank monetary policies on the value of financial assets and liabilities; the conventional herd-like behaviour of stock markets; the effects of urbanisation and public housing supply on real estate prices; public investment in infrastructure, research and development and innovation; collective labour input into profitability of firms; and so on. In the second case, we may think of those 'born into wealth' and having endowments through inheritance. A tax on wealth in these contexts can be viewed as redistributing the ownership of a part of the collectively-determined, privately-appropriated wealth of a nation (especially where the tax takes the form of an equity participation in the given asset), as well as regulating the perpetuation of inequalities through inheritance. Third, the accumulation of wealth amid high and rising income and wealth inequality can hinder the proper

functioning of democratic institutions, veering from the interests of the wider public towards those of a narrow 'elite', who can use their economic power to influence the legislative process. Finally, personal capital gains taxes are usually levied only on realised gains, which generates lock-in effects on capital and makes accrued capital gains self-reinforcing. In many countries, untaxed capital gains are 'forgiven' after the donor's death, which significantly increases the concentration of wealth. Thus, an annual net wealth tax would at least partially tax the accrued capital gains, easing the concentration cycle.

Historically, annual wealth taxes are less sensitive for the mass of the population than many other direct taxes but have been put into practice by governments much less often. In the 20th century, this may have been due to the exceptional egalitarian levelling in the wealth distribution from exogenous shocks (wars) and endogenous policies (capital levies, capital controls, nationalisations, interest rate ceilings, rent controls, public housing initiatives, etc.) that many countries experienced or implemented. However, in recent decades, this alignment of factors has ceased to exist, as the combination of financial deregulation with government de-nationalisation and capital and trade liberalisation has brought about rising inequality levels, and thus given recurrent wealth taxes greater relevance as a tool to deal with inequality and social injustice.

## **Principles of wealth tax and international evidence**

Supporters of wealth taxation, such as Rudnick and Gordon (1996), argue that progressive income taxation cannot be the only strategy to improve tax fairness. Many authors, such as Diamond and Saez (2011) and Jacobs (2013), have criticised the high reliance placed on labour taxation as opposed to capital and wealth taxation. Consumption and labour taxes

have generally low impact among the wealthiest individuals, something that could be mitigated by the introduction of a progressive wealth tax. Nevertheless, top wealth holders (who may also be top income earners) may be oblivious to this fact and seek to influence political decisions through their economic power. This can result in political actions that protect their interests. Among 18 countries of the Organisation for Economic Co-operation and Development (OECD), the bottom 40 per cent hold only 3 per cent of household wealth, while the top 1 per cent hold 20 per cent (OECD 2018). In addition, Saez and Zucman (2019) found that the wealth share of the top 0.1 per cent in the United States increased from 7 per cent in the late 1970s to 22 per cent in 2012.

Indeed, in advanced economies, real estate (especially the primary residence) is the main wealth asset among families within percentiles 20 to 90 of the wealth distribution, while financial assets become more important at the top (ibid.). These results are backed up by Alvaredo et al. (2018) for France, Spain and the U.S. While local immovable property taxes mainly focus on middle-income families, a progressive wealth tax on all asset categories would be better able to effectively tax the wealthiest.

The last few years have seen a surge in the favourability of wealth taxes. For example, Saez and Zucman (2019) estimate that while the 0.1 per cent richest families in the U.S. hold 20 per cent of the country's wealth, the bottom 90 per cent hold 25 per cent. The authors argue that the introduction of a wealth tax could generate 1 per cent of gross domestic product (GDP) in revenues with a tax rate of 2 per cent on 75,000 families with wealth above USD50 million, including a surtax of 1 per cent on wealth above 1 billion dollars. The authors acknowledge that wealth tax evasion can be a significant challenge. However, they cite Seim (2017)

**TABLE 1: Main features of wealth taxes (selected countries, 2019)**

Country	Competence	Tax base	Tax unit	Tax threshold <sup>(1)</sup>	Tax rates (%) <sup>(2)</sup>
Luxembourg	Central	Net wealth	Corporate	No threshold	0.5
Switzerland	Regional and Local	Net wealth	Personal	180,000 <sup>(3)</sup>	0.1 to 0.94
Uruguay	Central	Net wealth	Personal and corporate	120,000	0.7 to 2.8
Colombia	Central	Net wealth	Personal and corporate	1,300,000	1.0
Norway	Regional and Local	Net wealth	Personal	120,000	0.85
Argentina	Central	Gross wealth	Personal	70,000	0.25 to 0.75
Spain	Central and Regional	Net wealth	Personal	700,000	0.2 to 2.5 <sup>(4)</sup>

Notes: (1) In 2018 EUR (market exchange rates, approximate values). (2) As share of central government revenues, except Norway and Switzerland (as share of subnational revenues). (3) Canton of Geneva. (4) In Spain, regional governments can increase the national tax rates or apply exemptions. In Catalonia, tax rates vary from 0.2 per cent to 2.75 per cent, but the wealth tax is not levied in Madrid.

Source: Authors' elaboration based on data from the Ministries of Finance of the selected countries.

and Jakobsen, Kleven, and Zucman (2018), who argue that this can be minimised with strong enforcement, sanctions for the suppliers of tax evasion services, and third-party reporting of wealth, as exemplified by Sweden and Denmark. Londono-Velez and Avila-Mahecha (2018), studying the wealth tax in Colombia, note that tax evasion is a large obstacle in developing countries and highlight the importance of third-party reporting to improve the compliance of taxpayers at the very top of the distribution. This is largely a political problem of dedicating adequate resources to the tax administrations in each country.

In the early 1990s, there were many discussions about the feasibility of wealth taxes in Western Europe, which resulted in their abolition in many countries. Bird (1991) notes that between 1965 and 1988, wealth and inheritance taxes dropped from 0.5 per cent to 0.4 per cent of GDP in OECD countries. In addition, OECD (2018) published a comprehensive survey of wealth taxes in Europe due to the renewed interest in applying tax incidence in a more equitable way. The study found that despite being more distortive and less equitable than a broad personal capital income tax, wealth taxes can complement existing taxes. Indeed,

as argued by Kessler and Pestieau (1991) wealth tax revenues have been very low in Europe due to four main reasons: (1) few countries ever taxed corporate wealth; (2) the minimum tax threshold as varied greatly, being over 70 times higher in France than in Luxembourg; (3) many countries limited the annual income share that could be taxed by both the personal income tax and the wealth tax; and (4) real estate was commonly undervalued and there was no declaration of overseas properties.

Before 1990, all Western European countries implemented a recurrent wealth tax, except for Belgium, Portugal and the UK. Since 1990, it was abolished in Austria (1994), Denmark and Germany (1997), Iceland (2005), Finland (2006), Sweden (2007), Spain (2008), Greece (2009), and France (2018). Due to the fiscal crises in Europe starting in 2009, the tax was reinstated in Spain (2011) and temporarily in Iceland (2010-2014). It remains active in Luxembourg, Norway, Spain, and Switzerland. In comparison, in Latin America there are wealth taxes only in Argentina, Colombia and Uruguay. However, the tax is scheduled to be abolished in Argentina and Colombia. Table 1 shows the structure of the wealth tax for selected countries in 2019.

In five of these countries (exceptions include Luxembourg, Uruguay and Colombia), the tax base is limited to personal wealth. On the other hand, tax revenues tend to be higher in the three

**TABLE 2: Wealth tax revenues (selected countries, 2000-19, as a percentage of GDP)**

Country	2000-2003 <sup>(1)</sup>	2004-2007 <sup>(1)</sup>	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Luxembourg	2.37	2.26	1.90	1.94	2.07	1.99	2.04	2.10	2.16	2.52	2.62	2.73	2.82	2.91
Switzerland	1.20	1.20	1.19	1.20	1.17	1.13	1.12	1.17	1.21	1.24	1.26	1.28	1.32	1.34
Uruguay	0.75	1.01	1.05	1.18	1.08	1.06	1.06	1.06	1.14	1.11	1.05	1.01	0.95	1.00
Colombia	0.48	0.18	0.69	0.44	0.41	0.72	0.66	0.63	0.58	0.69	0.51	0.42	-	0.09
Norway	0.53	0.55	0.56	0.56	0.55	0.55	0.55	0.56	0.57	0.45	0.54	0.54	0.57	0.58
Argentina	n.d.	0.30	0.29	0.32	0.31	0.27	0.27	0.31	0.31	0.31	0.24	0.22	0.11	0.15
France	0.16	0.19	0.21	0.18	0.22	0.21	0.24	0.21	0.24	0.24	0.22	0.22	-	-
Spain	0.20	0.20	0.26	0.06	0.06	0.06	0.14	0.20	0.18	0.18	0.18	0.18	0.18	0.18
Iceland	0.70	0.10	-	-	0.24	0.37	0.53	0.47	0.54	-	-	-	-	-

Note: (1) Average value in the period.

Source: OECD (2021).



exception countries due to their broader tax base. Argentina is the only case where the tax covers wealth that is gross of debt. In Spain, the tax is characterised by notable exemptions and limits—income and wealth taxes combined cannot exceed 60 per cent of a taxpayer’s income, and primary residences and certain types of individual corporate shares are exempt, while autonomous communities can regulate exemptions to the point of offering full rebates to taxpayers (as in the case of Madrid).

Tax thresholds vary greatly among the selected eight countries, from only EUR5,000 of corporate wealth in Luxembourg to EUR1,300,000 of individual wealth in Colombia. Spain also has a high threshold of EUR700,000, while in the other countries it varies between EUR110,000 and EUR260,000. The tax rates are proportionate or progressive, generally between 0.5 per cent and 1.5 per cent.

Table 2 shows that wealth tax revenues have been stable since 2000: 0.78 per cent of GDP on average (or 0.5 per cent of GDP in median values). However, it is important to note that according to OECD (2021), wealth tax revenues were around 0.45 per cent of GDP between 1970 and 1999 in the 12 countries that adopted the tax (Austria, Canada, Denmark, Finland, France, Germany, Iceland, Luxembourg, Netherlands, Norway, Sweden, and Switzerland).

### The Brazilian Tax on Large Fortunes

There are valid arguments for the introduction of a wealth tax in Brazil, most notably the country’s persistently high levels of inequality and the significant levels of private wealth held domestically. Moreover, the implementation of a wealth tax would be a democratic and transparent way to directly track and assess the distribution of wealth among the population. Even if revenues from the tax are relatively low, following international experience, its primary function should be its distributive mechanisms.

Brazil’s 1988 Constitution states that a ‘Tax on Large Fortunes’ (*Imposto sobre Grandes Fortunas—IGF*) must be implemented by a Supplementary Federal Law, which requires a majority vote by one half of the MPs in both houses of Congress. Nevertheless, despite two

parliamentary votes, the IGF has never been implemented. In 2017, there were 23 bills that intended to implement the IGF, 18 in the Lower House (Chamber of Deputies) and 5 in the Senate. A bill was approved by the Senate in 1989 and forwarded to the Chamber of Deputies, but was rejected after 11 years of proceedings by the Finance and Taxation Commission of the Chamber of Deputies in 2000. This bill would introduce the taxation of all net wealth above 26.490 monthly minimum wages under progressive tax rates between 0.1 per cent and 0.7 per cent. The main reason for rejection was the abolition of wealth taxes in several European countries during the 1990s, their alleged high administrative costs and low revenue potential. Subsequently, in 2008, there was another bill voted in the Senate’s Commission of Economic Issues, and it too was rejected, essentially for the same reasons as the previous bill. However, it intended to tax all net wealth above 24.096 monthly minimum wages at a proportional rate of 1 per cent.

In 2016, the Federal Revenue Service Bureau (*Secretaria da Receita Federal—SRF*) published a report based on statistics from income tax declarations, including the net wealth of Brazilian taxpayers divided into income brackets (SRF 2017). The data reveal that a tax on large fortunes would have a meaningful tax base. Indeed, the wealth distribution among Brazilian taxpayers was more concentrated than its income equivalent, which is already one of the most concentrated in the world. The 1.2 per cent highest income taxpayers (324,843 taxpayers with a monthly income above BRL52,800 in 2016) received 22.7 per cent of reported income and 32.9 per cent of reported net wealth.<sup>4</sup> Furthermore, the 0.1 per cent highest income taxpayers (25,785 taxpayers—approximately the richest 0.02 per cent adults in the population) hold 10.5 per cent of income and 16.6 per cent of wealth. Their average wealth amounts to just over 50,000 multiples of the minimum wage. Concerning wealth components, 46 per cent by financial assets, 37 per cent of the declared wealth comprised immovable property, and 7 per cent comprised vehicles.

Therefore, an effective wealth tax of 3 per cent of this stock of wealth could levy BRL38.84 billion (or 0.63 per cent of GDP

in 2016). This scheme would mainly affect approximately 30,000 taxpayers with a stock of wealth above BRL50 million.

One possible proposal is the introduction of an annual tax on net wealth above a high initial threshold to target the ‘super-rich’. It would apply to total household wealth to avoid intra-household re-allocations of wealth. Single-person households would face lower thresholds (e.g., the proposed thresholds divided by 2). The schedule could contain 4 brackets, each expressed as multiples of the monthly minimum wage, starting at 0.1 per cent and reaching 4 per cent, thus improving upon existing international schedules in terms of distributive impact. The schedule could apply to values defined as multiples of the statutory minimum wage and is expressed in effective tax rates (not marginal rates). This scheme is defined as an “Effective Tax Rate System”. Fortunes between each scale would be taxed progressively, such that the effective tax rate evolves continuously according to accumulated wealth. For example, a person possessing a fortune equal to 150,000 minimum wages—a halfway point between 50,000 and 250,000 minimum wages—would pay an effective rate of 2.5 per cent, halfway between 2 per cent and 3 per cent.<sup>5</sup>

One issue that always comes up in debates about wealth taxation is whether possessing or transferring wealth constitutes tax avoidance and evasion. However, the SRF already has access to a registry of financial assets—the Declaration of Information on Financial Transactions (*Declaração de Informações sobre Movimentação Financeira—DIMOF*)—which are most susceptible to tax evasion. Thus, the Revenue Service knows the owners and jurisdiction of the financial assets of individuals included in the income tax declarations. This monitoring programme could be expanded to cover all privately-owned financial assets.

For greater effectiveness, Brazil should also cooperate with foreign tax authorities to curb cross-border evasion. In its international negotiations, the country should back the proposal for the automatic exchange of bank information, to be encouraged through commercial sanctions by regional coalitions on non-cooperating

countries and verified by a 'global financial registry' under the supervision of an international public organisation (Zucman 2015).<sup>6</sup> However, it should be noted that this type of international cooperation is not strictly necessary for Brazil to enact its own wealth tax legislation. Domestic financial regulations would significantly contribute to establishing a solid tax base. Furthermore, unilateral sanctions on small tax havens imposed by a country of Brazil's size and economic importance (ranging from prohibitive tariffs on goods to the revoking of licensing for services such as banking) could be feasible and effective.

### Conclusion

This article presented global perspectives on wealth taxes and analysed the current status of such a tax in Brazil, suggesting some appropriate reforms. Despite the previous existence of wealth taxes in most countries of Western Europe and some countries of South America (Argentina, Colombia and Uruguay), now they only exist in Switzerland, Luxembourg, Norway, Spain, Colombia, and Uruguay. In Brazil, the wealth tax (or the IGF) is foreseen in the country's 1988 Constitution, but it has never been implemented by a Supplementary Federal Law.

Nevertheless, the wealth data in the income tax statistics reveal that Brazil has an extremely high concentration of wealth, and the IGF's revenue potential of over 0.6 per cent of GDP according to our proposed scheme is not insignificant, being the same amount levied by the current urban property tax (*Imposto Predial e Territorial Urbano*—IPTU) in 2018. Our proposal for the wealth tax basically considers an effective wealth taxation of 3 per cent (under a progressive schedule) for the 0.1 per cent richest taxpayers (who hold 17 per cent of reported wealth among income taxpayers). With at least an additional 0.4 per cent of GDP from a reformed inheritance tax (an amount close to that of Japan), a national system of taxation on the possession and transfer of personal wealth could re-direct about 1 per cent of GDP, which is significant.

However, the importance of wealth taxation goes beyond the mobilisation of revenues. The perspectives on tax reform presented in this article are first and foremost intended

to foster a space for ideas and debate in a country where this topic is becoming ever more salient (even if it has been designed as a long-term strategy due to the current conservative political scenario in Brazil after the 2018 national elections). These rough proposals should be seen as blueprints for a more socially just and economically efficient tax system.

Of all the possible mechanisms that could be leveraged to change a society's vertical structure, progressive taxation would seem one of the most peaceful and democratic. In the 20th century it became one of the main pillars of social democratic movements and parties in Western liberal democracies, including less advanced countries such as Brazil (and others in Latin America). This is because many social thinkers of the time identified an inherent stability resulting from political democracies that do not also democratise their economic systems, giving rise to plutocracies. This situation leads to increased social tension and can result in the rise of violent transitions or regimes. It can be argued that World War II was the turning point for social democracy, seeking to prevent the rise of fascism again in the future. We should not need to rely on violent conflict to implement progressive policies in the interests of broad segments of society. ●

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1. This article has been adapted from Morgan and Carvalho Junior (2021).
2. Institute for Applied Economic Research (Ipea).
3. World Inequality Lab and Paris School of Economics.
4. It should be noted that the national concentration (among all Brazilian adults, not just those declaring income and assets to the government) is likely to be much higher. Roughly 20 per cent of the adult population is covered in Brazil's income tax statistics. Some caution with these wealth inequality estimates is necessary as the assets and liabilities declared in personal income tax returns are valued at their cost of acquisition, not necessarily their up-to-date market values, which can underestimate wealth values.
5. We propose an initial bracket of 10,000 monthly minimum wages with a low effective tax rate of 0.1 per cent to avoid large threshold effects. This lower bracket would have about 40,000 taxpayers with a minimum tax payment of 10 minimum wages, while the three highest brackets would have about 30,000 taxpayers. In addition, this threshold effect could be further minimised if a tax credit, of for example 5 minimum wages, were to be granted to all taxpayers.
6. A global financial registry would in effect identify the owners and jurisdiction of all global financial assets in circulation, allowing national fiscal administrations to verify that taxpayers declare all their financial assets accurately.

# Relevance of wealth taxes in tackling the COVID-19 crisis and inequality in India<sup>1</sup>

Sakti Golder<sup>2</sup>

Economic inequality—that is, income and wealth inequality—is currently very high in India compared to international and historical standards. The COVID-19 pandemic is poised to make the situation even worse in the absence of proper policy interventions. Although inequality in India has been rising rapidly since early 2000s, no deliberate interventions have been carried out to address this critical problem. Consequently, like many other countries, India is now plagued by various types of inequalities: income inequality, wealth inequality, gender inequality, etc. Wealth inequality is the starkest form of inequality.

Despite the variation in inequality estimates across studies, it is well-established that inequality in India is high and increasing rapidly. The Global Wealth Report 2013 (Credit Suisse 2013) revealed that from 2000 to 2013, India's private wealth reportedly increased by 300 per cent—from USD1.2 trillion to USD3.6 trillion. The number of billionaires in India increased from only 2 in the mid-1990s to 46 in 2012.<sup>3</sup> As per Forbes' World's Billionaires List 2021,<sup>4</sup> the number of billionaires has increased further to 140. Despite the debilitating impact of COVID-19 on the economy, India has added 38 billionaires to the list in 2021 (Zompa 2021). The wealth of the top 11 billionaires in India increased by INR7 trillion (USD 95 billion)<sup>5</sup> during the first six months of the pandemic, which would be enough to run the Ministry of Health for ten years (Oxfam India 2021).

This has also been reinforced by the Credit Suisse report, which shows that the wealth share of top 1 per cent in India is soaring. Figure 1 displays that during the period from 2002 to 2011, the wealth share of top 1 per cent of population increased from 15.7 per cent to 46.8 per cent. In addition, the total wealth held by the top decile of the population increased from 52.9 per cent in 2002 to 72.6 per

cent in 2011. As the wealth share of the top strata increases, the wealth share of the bottom strata shrinks proportionately. There was no significant decline in wealth inequality from 2011 to 2020.

Chancel and Piketty (2017) as well as Anand and Thampi (2016) also observed the extremely unbalanced accumulation of wealth in favour of the top strata of the population. The Government of India may consider the redistribution of income as the most effective tool in tackling the problem of inequality. Among the various types of property taxes, those with a progressive bias (recurrent property taxes, net wealth taxes and inheritance taxes), considered in this article as 'overall wealth taxes' can effectively hit at the root of inequality. Piketty rightly pointed out that, in the absence of wealth or inheritance taxes, the phenomenon of increasing concentration of wealth very likely manifested in India.<sup>6</sup>

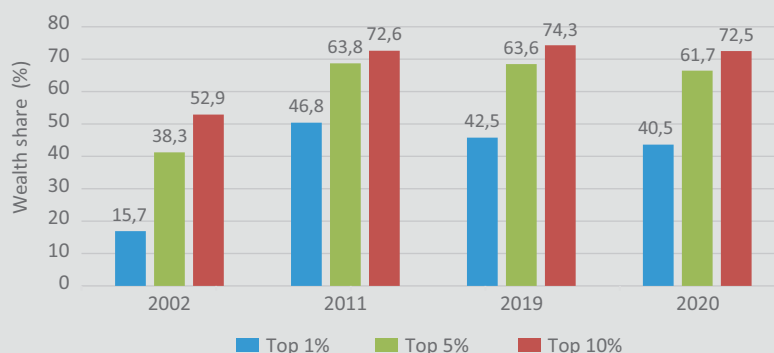
Wealth taxes could be an option to curb growing social inequity and injustice, as well as generate additional revenue. Recently, in one of its reports, the World Bank (2016) states that property and inheritance taxes can promote progressivity in tax systems and increase revenues,

helping to further limit intergenerational inequality. The report further reveals that in developing countries, property taxes (overall wealth taxes) are generally underutilised, representing about 0.5 per cent of gross domestic product (GDP), and raises concerns about the declining trend of wealth tax collections in developing countries, at a time when the concentration and accumulation of wealth are increasing worldwide.

## Overall wealth taxes: international evidence

Many G20 and BRICS countries have mobilised substantial amounts of resources in the form of wealth taxes (Golder 2018). Countries such as the United States, Canada, Japan, France, United Kingdom, New Zealand and others collected substantial revenues from overall wealth taxes over the years. In 2019, the United Kingdom collected taxes equivalent to 3.3 per cent of its GDP from overall wealth taxes, representing 10 per cent of its total tax revenue. Among other high-income countries, the U.S., Canada, Japan, and France also collected as much as 11.4 per cent, 9.3 per cent, 7.2 per cent and 7 per cent of their total tax revenues, respectively, from overall wealth taxes.<sup>7</sup>

**FIGURE 1: Trends in the share of wealth (as a percentage) for different percentiles of the population from 2002 to 2020 in India**



Source: Credit Suisse Global Wealth Databook 2011; 2017; 2019; 2021.





Photo: Chetan Karkhanis/sandeepachetan.com. A public laundry in Kochi, India, 2016 <is.gd/LNU8l4>.

“ The underutilisation of overall wealth taxes in mobilising resources is evident in India, as in other developing countries.

Even South Africa, a country with a similar socio-economic profile to India, mobilised a substantial amount—5.2 per cent of its total tax revenues—from overall wealth taxes. Although comparable figures for India are not available in the Organisation for Economic Co-operation and Development’s (OECD)’s Global Revenue Statistics Database, an estimate (Prakash 2013) based on the International Monetary Fund (IMF)’s Government Finance Statistics database shows that India’s revenue collection from overall wealth taxes was only 0.37 per cent of GDP in 2009-2010, which was the lowest among all BRICS and G20 countries, except for Turkey and Mexico. It only represented 3.1 per cent of the country’s total tax revenue for the period. Lower revenues from overall wealth taxes is attributable to the government’s failure or lack of will to broaden the wealth tax bases in India compared to G20 and BRICS countries, as well as a large number of exemptions.

### Wealth taxes in India

The underutilisation of overall wealth taxes in mobilising resources is evident in India, as in other developing countries. Even though inequality has been growing steadily in the country over the years, there has been no deliberate tax policy intervention. Quite the contrary: the Government of India abolished the inheritance tax in March 1985, the gift tax in October 1998, and the net wealth tax in April 2016. Therefore, only the recurrent property taxes levied by subnational governments remain. Long-term capital

gain taxes have also become more liberal<sup>8</sup> since 2004-2005. In addition, the government cut corporate income taxes from 30 per cent to 22 per cent in 2019, which is one of the lowest rates among G20 countries, further encouraging the accumulation of private wealth.

There is a dearth of relevant literature in developing countries to assess the revenue generation potential of wealth taxes.

Among the handful of comprehensive studies on wealth taxes in India, Krishnan (1972) estimated that the potential yields from property and net wealth taxes in 1969-70 could vary from INR2.2 to INR3.5 billion (USD30 million to USD48 million), which ranges between 5.2 per cent and 8.3 per cent of total tax revenue, given the total tax revenue collection in 1969-70 of INR42 billion (USD570 million).

If we assume that the proportion of property and net wealth tax collection have remained the same over the years, around INR699 billion (USD9.5 billion) to INR1,116 billion (USD15.2 billion)—given the total tax revenue of INR13,445 billion (USD182.5 billion in 2020-21)—could have been collected in revenue from these wealth taxes, representing 6.9 per cent of GDP. Mobilising this amount is quite possible, given that private wealth in India has risen rapidly over the years, and therefore, the share of private wealth out of the country’s total wealth has also increased substantially.

Many countries have taken several progressive policy decisions to tackle

the unprecedented crisis resulting from the COVID-19 pandemic. A temporary solidarity tax on the wealthy and ‘super-rich’ has been proposed in Peru, and Argentina’s Senate has approved a one-off wealth tax that affects the country’s richest 10,000 citizens; this is expected to raise around USD3 billion to spend on the social sector and those impacted by the pandemic (Oxfam India 2021).

To address the health crisis and create more fiscal space for the government, a policy paper titled “Fiscal Options and Response to the COVID-19 Epidemic (FORCE 2020)”, was submitted to the Prime Minister’s Office by an association of officers from the Indian Revenue Service. The main recommendations of this policy paper include: raising the income tax rate to 40 per cent (for who earn INR10 million and above per year); a one-time COVID-19 tax of 4 per cent on taxable income over INR1 million; the re-introduction of a wealth tax for those who have a net wealth of INR50 million and above; and the re-introduction of an inheritance tax. These are very relevant policy measures given the current level of inequality in the country and the devastating impacts of COVID-19.

The outlook of the Annual Economic Survey (Government of India 2021) was to focus on growth, instead of addressing inequality. The Union Budget 2021-22 did not take any new measures to reintroduce wealth taxes or introduce inheritance taxes. Even a 4 per cent wealth tax on India’s 954 richest families could have

“ Mobilising more resources through overall wealth taxes can also curb inequality through the redistribution of income.

raised funds equivalent to 1 per cent of GDP, which is almost equal to the country's total health budget.

### Conclusion

As India's tax-to-GDP ratio is very low compared to many developed and even several developing countries, the re-introduction of a net wealth tax and inheritance tax, as well as the strengthening of the personal capital gains tax and subnational property taxes, could broaden the direct tax base, make the country's tax structure more progressive, and create more fiscal space for the government to invest in the social sector or other priority areas. Mobilising more resources through overall wealth taxes can also curb inequality through the redistribution of income. By reintroducing wealth taxes and taxing the 'super-rich', the Government of India could raise a considerable amount of resources, which could be used in rebuilding the pandemic-ravaged economy.

The government could redesign the whole gamut of wealth taxes, choosing among the most buoyant:<sup>9</sup> i.e., property taxes, inheritance taxes, capital gains taxes, taxes on dividends, etc. and implementing them properly. The rate for each specific tax should be fixed after thorough review. The threshold limit may be kept high, but exemptions should be kept as few as possible to minimise tax avoidance. ●

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1. This article draws from Golder (2018).
2. International Budget Partnership (IBP). The views expressed in this article are the author's own.
3. See: <<https://bit.ly/3BxCEHQ>>.
4. See: <<https://www.forbes.com/billionaires/>>.
5. Average Exchange Rate for the year 2021, i.e., 1 USD = 73.66 INR is used for all calculations.
6. Piketty (2014) has argued that income from capital and inherited wealth have been powerful drivers of inequality in advanced capitalist countries up to World War I, as well during the period since the 1970s. He pointed out that up to the early 20th century, capital income—as opposed to labour income—predominated at the top of the income distribution. Minimal taxation on wealth at that time ensured that wealthy individuals could easily reinvest a substantial part of their income. Consequently, their wealth and incomes grew at a faster rate than the economy, thus reinforcing their economic dominance. When these wealthy individuals died, their wealth passed on to their heirs. As a result, inherited wealth was concentrated in the hands of a very small minority.
7. Calculations based on the OECD's Global Revenue Statistics Database: <<https://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm>>.
8. Prior to 2004, long-term capital gains on securities (gains realised on the disposal of securities held for more than one year) were taxed at a flat 10 per cent, without indexation. Short-term capital gains were taxed progressively, as was normal income. Since 2004–2005, long-term capital gains have been exempted from tax in lieu of the Securities Transaction Tax and short-term capital gains are taxed at a flat 15 per cent rate.
9. A tax is said to be 'buoyant' if the tax revenues increase more than proportionately in response to an increase in national income or output.

# A wealth tax for South Africa: A proposal to help finance COVID-19 pandemic measures

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The introduction of a wealth tax has been discussed periodically in South Africa's recent democratic history. However, as the devastating social and economic consequences of the COVID-19 pandemic continue, the country is left grappling with how it can provide both social and economic support, considering its considerable fiscal challenges.

Even prior to the pandemic, South Africa's inequality was extreme and left much of society vulnerable to its consequences. The expanded unemployment rate was 36 per cent in the first quarter of 2019 (Stats SA 2019), while about half of the population was already in debt, or had near-zero net wealth to rely on, as lockdowns and job losses halted access to incomes, according to our new research (Chatterjee, Czajka, and Gethin 2021b).

The impact of the pandemic is slowly being realised: the expanded unemployment rate has jumped to 40.8 per cent the first quarter of 2021 (Stats SA 2021). A survey into the impact of the pandemic on South Africa shows that approximately 10 million people and 3 million children were living in households affected by hunger in April-May 2021 (Bridgman, Van der Berg, and Patel 2021). The government

has responded with various measures, including a COVID-19 Social Relief of Distress Grant (SRD) of ZAR350 (around USD24)<sup>2</sup> per month, reinstated in July 2021 until March 2022. In this context, we propose that South Africa should revisit and seriously consider the implementation of a wealth tax, to be able to roll out social and economic support programmes while supporting fiscal sustainability.

## Revisiting the wealth tax debate in South Africa

South Africa has considered a wealth tax in its recent history. During the transition to democracy, a wealth tax was proposed as a form of redistributive justice and to fund policies to address the colonial and Apartheid-era practices and structures that made South Africa one of the most unequal countries in the world (Terreblanche 2018). Instead, the government adopted a 'transitional levy', a one-off tax on incomes and profits, providing a revenue supplement to support the integration of the new and old government administrations (Department of Finance 1994). In 2013, the Minister of Finance set up the Davis Tax Committee (DTC) "to assess our tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability". Part of the Committee's assessment considered

the feasibility of a wealth tax and concluded that though one may be desirable, the lack of data on ownership made it unfeasible (Davis Tax Committee 2018).

However, our new estimates of asset ownership shed new light on the exceptionally extreme concentration in the distribution of household wealth in South Africa since 1993 (Chatterjee, Czajka, and Gethin 2021b). This estimation acts as a tax base, and we calculate that a progressive wealth tax on the richest 1 per cent could raise a significant level of revenue, making this tax worthy of serious consideration (Chatterjee, Czajka, and Gethin 2021a). Moreover, we contend that many of the arguments used to dismiss a wealth tax, which claim that the costs and risks outweigh the benefits, are not grounded in evidence, and ignore South Africa's specific context.

## Wealth inequality in South Africa

Much research on South Africa has focused on poverty and income inequality (e.g. Leibbrandt et al. 2010). Little is known about ownership of assets in the country. Net wealth is the sum of all assets minus any liabilities. Assets include cash, bank deposits, pensions, life insurance, property, bonds, and stocks. Liabilities include mortgages and other loans, such as retail store credit accounts or loans from friends, family and money lenders.

**TABLE 1:** The distribution of personal wealth in South Africa in 2017

	Number of adults	Wealth threshold (ZAR)	Average (2018 ZAR)	Total (2018 ZAR)	Wealth share	% of GDP
Full population	35,600,000		326,000	11,600	100%	249.2%
Bottom 90% (p0p90)	32,040,000		52,300	1,700	14.4%	36.0%
Bottom 50% (p0p50)	17,800,000		16,000	-300	-2.5%	-6.1%v
Middle 40% (p50p90)	14,240,000	27,700	138,000	2,000	16.9%	42.1%
Top 10% (p90p100)	3,560,000	496,000	2,790,000	9,900	85.6%	213.2%
Top 1% (p99p100)	356,000	3,820,000	17,830,000	6,300	54.7%	136.4%
Top 0.1% (p99.9p100)	35,600	30,350,000	96,970,000	3,500	29.8%	74.2%
Top 0.01% (p99.99p100)	3,560	146,890,000	486,200,000	1,700	14.9%	37.2%

Note: The table shows the distribution of household wealth in South Africa in 2017. The unit of observation is the individual adult aged 20 or above. Wealth thresholds are expressed in 2018 ZAR. Interpretation: in 2017, the minimum net wealth required to belong to the top 1 per cent (356,000 individuals) was about ZAR3.8 million. The top 1 per cent average wealth was ZAR17.8 million; the top 1 per cent owned about 55 per cent of total wealth in South Africa.

Source: Authors' elaboration combining surveys, tax microdata and macroeconomic balance sheets statistics.



**TABLE 2:** Marginal tax rates of proposed wealth tax schedules

Wealth group	Number of adults	Wealth threshold (ZAR)	Low tax	Moderate tax	High tax
Top 1%	356,000	3,820,000	1%	3%	3%
Top 0.1%	35,600	30,350,000	2%	5%	7%
Top 0.01%	3,560	146,890,000	3%	7%	9%

Source: Authors' elaboration.

To estimate the distribution of household wealth in South Africa, we combine surveys, income tax microdata, and macroeconomic balance sheets statistics published by the South African Reserve Bank (SARB). Studies that rely on household surveys underestimate the top end of the distribution. To overcome this challenge, we apply a "mixed income capitalisation method" (Saez and Zucman 2014; Garbinti, Goupille-Lebret, and Piketty 2021) to capture incomes and assets that are particularly prevalent at the top end of the distribution, and scale them to match the aggregate asset values recorded in the national accounts. This ensures that the resulting estimates of wealth inequality are fully consistent with balance sheets series published by the SARB.

The results of this analysis are striking. First, we find extreme levels of wealth inequality (see Table 1). In 2017, the 10 per cent richest South Africans (3.6 million adults with a net worth over ZAR496,000, or

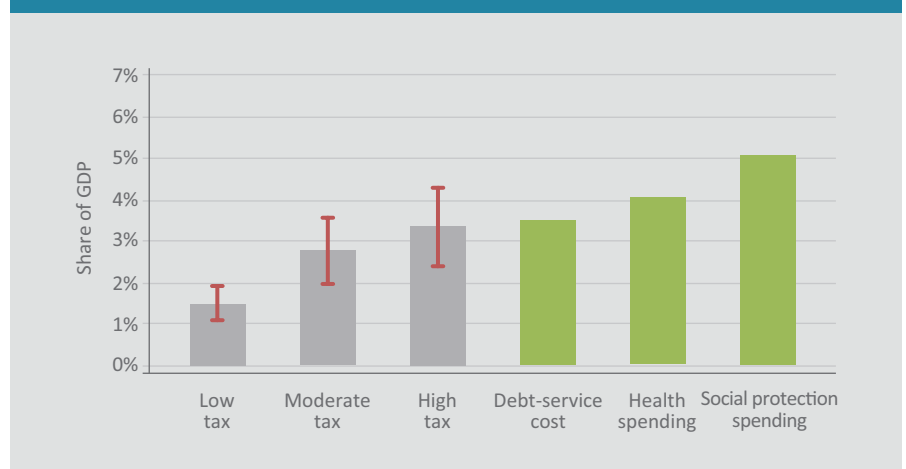
USD33,000) owned 86 per cent of wealth, with an average of ZAR2.8 million per adult (USD190,000). In contrast, about 18 million (the poorest 50 per cent) were either in debt or had near-zero savings. With an average net worth of ZAR486 million (USD33 million), the top 0.01 per cent richest (3,500 individuals) owned 15 per cent of wealth. This was more than the 32 million poorest people combined. Moreover, these extreme inequalities extended to all categories of assets. The concentration of ownership has remained stable since 1993—if anything, it may even have increased within top wealth groups. Today, wealth inequality in South Africa is significantly higher than what has been estimated in any other country in the world, including Russia, China, India, the US, or France.

**Wealth tax estimates**

Drawing on our new estimates of the wealth distribution, we estimate the potential income that could be generated

“ Even prior to the pandemic, South Africa’s inequality was extreme and left much of society vulnerable to its consequences.

**FIGURE 1:** Potential wealth tax revenue relative to selected government expenditures



Note: The figure compares the expected revenue from a low, moderate, or high progressive wealth tax with that obtained from selected expenditures in South Africa as a share of GDP in 2017. Confidence intervals correspond to evasion rates of 10 per cent (lower bound), 30 per cent (middle estimate) and 50 per cent (upper bound). A moderate wealth tax with a 30 per cent evasion rate could raise 3 per cent of GDP.

Source: Authors' estimations (wealth taxes), Treasury budget report 2019 (other figures).



Photo: IMF Photo/James Oatway. Young man on the street during lockdown in Alexandra Township, Johannesburg, 2020 <[is.gd/LNU8I4](https://www.is.gd/LNU8I4)>.

“ Today, wealth inequality in South Africa is significantly higher than what has been estimated in any other country in the world.

from a wealth tax exclusively targeted at the top 1 per cent. We consider three tax schedules: a ‘low’ wealth tax, with marginal rates varying from 1 per cent to 3 per cent, a ‘moderate’ wealth tax (3 per cent to 7 per cent), and a ‘high’ wealth tax (3 per cent to 9 per cent, see Table 2). We have also created an online [wealth tax simulator](#), where interested users can choose their own tax schedules and expected evasion rates to estimate the corresponding tax revenue.

We make two key assumptions. First, we account for the economic downturn induced by the COVID-19 shock by making the (conservative) assumption that the market value of bonds and stocks has dropped by 20 per cent since 2017. Secondly, we propose three scenarios corresponding to different expectations regarding the ability of tax authorities to collect revenue and behavioural responses of taxpayers in response to the tax. In our benchmark scenario, we assume a 30 per cent evasion rate; our two other scenarios, which we take as a ‘confidence interval’, correspond to 10 per cent and 50 per cent evasion rates, respectively.

We estimate that a moderate wealth tax could raise about ZAR70 billion to ZAR160 billion, or 1.5 per cent to 3.5 per cent of GDP, depending on the rate of evasion. This revenue is considerably higher than existing wealth taxes: the moderate wealth tax would collect approximately 20 times more money than transfer duties, and as much as 60 times more than the

estate duty. Figure 1 illustrates potential revenues relative to gross domestic product (GDP) and selected government expenditures.

#### Practicality of a wealth tax in a developing country

The main criticism of this type of proposal is that the capacity to implement a wealth tax simply does not exist, and would instead lead to capital flight at a time when it is most needed. However, South Africa is already relatively well placed. Third-party reporting (rather than self-reporting) is crucial to the success of such a tax, and the South African Revenue Service (SARS) already uses third-party reporting to collect data for its dividend tax. SARS is currently developing a third-party data platform to accommodate bulk submissions of third-party data for certain types of taxes. One of the most challenging aspects of implementing the tax would be valuing property. This is already carried out to administer property taxes at a subnational level, and although these valuations are not performed consistently, they act as a basis to develop a national system. In the shorter term, there are property companies, such as Lightstone, that already collect data on market valuations, and data-sharing partnerships should be explored. Moreover, due to South Africa’s deep financial markets and extensive formal financial sector, the South African Reserve Bank already collects significant data on financial accounts, transactions and cross-border flows.

Capital flight is of course a risk, and strategies to ameliorate it could include tying tax payments to citizenship or implementing an exit tax. There is also more cooperation between tax authorities to clamp down on undeclared incomes and assets in foreign jurisdictions, including tax havens. The Automatic Exchange of Information promoted by the Organisation for Economic Co-operation and Development (OECD), for instance, could play an important role in limiting tax evasion. Capital flight implies people forfeiting opportunities that have led to their dominant ownership of wealth for the sake of avoiding a tax that barely makes an impact on their total wealth. Additionally, capital flight, tax evasion and tax avoidance are problems that all taxes face, and are due to various reasons, including corruption and policy effectiveness. Given the recent corruption scandals in the country, taxpayers would need guarantees that this special tax will be properly collected and spent. The South African National Treasury already uses ringfencing mechanisms to make revenue and spending for specific projects accountable. To answer potential criticism, the government could build on such rules to generalise more transparent practices.

A second theme of arguments against wealth taxes focuses on countries that have abandoned wealth taxes, without analysing the specific circumstances in which they were abandoned, the design of the taxes, or instances of success. As discussed extensively in Saez and

Zucman (2019) and elsewhere, the challenges faced by European wealth taxes were largely due to the specific context of tax competition across EU countries, as well as the low tax thresholds and numerous exemptions that made these taxes inefficient and unfair. Other examples, such as India, have struggled due to the introduction of significant exemptions. Crucially, discussions of these examples ignore that implementing a tax on net wealth has indeed been possible in a number of countries at a time when administrations were still entirely paper-based, such as Switzerland (1840), Denmark (1903), Finland (1919), Germany (1952), Ireland (1975), Spain (1977), and France (1982) (OECD 2018). Moreover, the success of a wealth tax should be evaluated on the basis of whether it raises sufficient revenue for a specific policy to deal with crises or reconstruction, where there are far more examples (Flores-Macias 2014). Most recently, Argentina instituted an additional wealth tax to cope with the health costs associated with the COVID-19 crisis, and although longer term effects are yet to play out, initial reports indicate that significant revenue has been received to support reconstruction policies (Doll 2021).

### Conclusion

Even prior to the COVID-19 pandemic, South Africa was one of the most unequal countries in the world. The devastating effects of the health crisis have further exacerbated the enduring hardships of the majority of the population, with the economy facing a difficult road to

recovery. A well-designed, targeted progressive wealth tax could, alongside other policies, contribute to providing the necessary support to both society and the economy, while promoting a more equitable distribution of the fiscal costs of the pandemic. While the optimal rates, tax base, and hence the amount of tax to be collected ultimately result from an informed collective policy choice, we hope that our new estimates of wealth inequality and potential tax revenue can contribute to this debate. ●

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2. USD1=ZAR14.87 as of 1 October 2021.

“The success of a wealth tax should be evaluated on the basis of whether it raises sufficient revenue for a specific policy to deal with crises or reconstruction.



Photo: IMF Photo/James Oatway. Man makes face masks in order to generate some income during the COVID-19 lockdown, Johannesburg, South Africa, 2020 <[is.gd/LNU8I4](https://is.gd/LNU8I4)>.



# Tax policy for an inclusive recovery<sup>1</sup>

*Khaled Abdelkader<sup>2</sup> and Ruud de Mooij<sup>2</sup>*

Even before the COVID-19 pandemic, income inequality in many countries was high and rising. Wealth inequality has been even larger, with the top 1 per cent of the global population holding almost half of the global wealth. The health crisis has exacerbated these preexisting inequalities by disproportionately affecting vulnerable groups, including low-skilled and informal workers. At the same time, several affluent individuals have fared very well. This large and growing inequality can lead to social unrest, risks undermining trust in government and can have adverse consequences for the post-pandemic economic recovery.

Governments can address inequality through effective social transfer programmes and better access to basic public services, such as health care and education. These public expenditures are especially important to support the poorest and most vulnerable people in society, thus reducing inequality from the bottom upwards. Financing these expenditures does not necessarily require taxes on the rich. They can also be financed by less progressive taxes, such as VAT and excises—often the predominant revenue sources of developing countries—as part of a progressive overall fiscal package. However, inequality can also be

reduced from the top downwards, using progressive taxes (whereby the average burden rises with income or wealth). This article discusses options for governments to pursue such progressive tax policy, both in advanced and developing countries.

## Taxing top incomes

The most straightforward way to tax high incomes is through the progressive personal income tax (PIT). Most countries do this by employing a threshold below which no PIT is due (to relieve low-income earners from paying tax), followed by marginal tax rates that increase stepwise with personal income. However, nearly 30 countries—mostly in Eastern Europe and Central Asia—adopt flat tax regimes, applying a single PIT rate to all incomes. The rate never exceeds 25 per cent and is often much lower. These countries have scope to increase the tax burden on the rich by raising marginal tax rates at the top of the income distribution. Elsewhere, top PIT rates vary. The global average is around 30 per cent, but in advanced economies the average is higher, at slightly above 40 per cent. This is still lower than in the 1980s when rates in advanced economies were, on average, close to 60 per cent. Top PIT rates have declined, especially at the end of the 20th century, but have been relatively stable over the past two decades. The burning question, of course, is: can these top PIT rates be increased?

High marginal tax rates distort incentives to work, learn and earn; moreover, they induce (legal) tax avoidance and (illegal) tax evasion. This imposes limits on how high the top PIT rate can be. A useful benchmark is the revenue-maximising rate, whereby an increase in the rate does not generate more revenue because of the behavioral responses by top earners—measured by the elasticity of taxable income. Studies estimating the revenue-maximising rate in advanced economies vary, but generally arrive at rates between 50 and 60 per cent. Countries with lower rates thus have some scope for higher top PIT rates to increase revenues from top earners. In developing countries, the revenue-maximising rate is probably lower due to weaker enforcement capacity.

Another important aspect of taxing the rich is how capital income is treated. In the US, for example, people in the top 0.1 per cent of the income distribution on average earn less than one quarter of their income in the form of wages (and for the top 0.001 per cent, this share is even less than 10 per cent), while the two largest sources of income for them are capital gains (over 40 per cent) and entrepreneurial income (over 25 per cent) (IRS 2020). Additionally, in other countries, capital income is consistently much more concentrated at the top of the distribution than labour income (Figure 1).

Over the past decades, income taxes on capital have declined in many countries. This coincided with a trend toward ‘dual income tax’ tax systems, in which labour and capital incomes are taxed separately. Typically in these systems, the progressive rate scheme discussed above applies only to labour income, while a flat rate applies to capital income, usually at a lower rate than the top PIT rate on labour. The relatively low tax on capital contrasts with the idea of the ‘global income tax’, in which the sum of an individual’s labour and capital income is taxed under the progressive rate structure. The global income tax appeared administratively complicated, however, especially because high marginal tax rates on capital induced ample tax avoidance and evasion.

**FIGURE 1:** Capital and labour top income shares, 2018 or latest

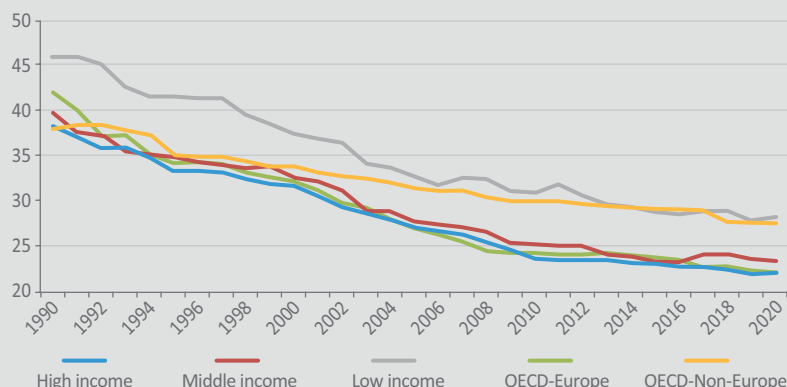


Source: Authors’ elaboration based on Luxembourg Income Survey data.



“ Entrepreneurial income is relatively vulnerable to tax avoidance and evasion.

FIGURE 2: Corporate tax rates across the world, 1990-2019



Source: Authors' elaboration based on the FAD tax database.

Nevertheless, recent developments provide scope to improve the taxation of capital income and could even allow for a revival of the global income tax. First, many countries have scope to reduce tax avoidance by applying the same effective tax rate to all forms of capital income (interest, dividends and capital gains), which is often not the case. Second, tax evasion can be reduced by better using third-party information (such as from individual bank accounts) or by employing (final) withholding taxes (collected from financial institutions and other large corporations). Recent developments in digitalisation make these enforcement efforts cheaper and more accessible. Moreover, advances in automatic exchange of information across borders provide scope for tax administrations to also address offshore tax evasion more effectively—although getting access to and using these data remains challenging for many developing countries.

There are still challenges regarding the taxation of capital gains and entrepreneurial income. Capital gains are almost always taxed upon realisation, rather than accrual, to avoid liquidity problems for taxpayers (i.e., having to sell assets to meet their tax obligations) or problems with measurement (such as for non-traded companies). However, this deferral induces people to postpone the realisation of capital gains. Moreover, many countries reduce taxes on long-term gains (or even allow outright exemption) to mitigate the impact of inflation.

Strengthening capital gains taxation in these countries can be an effective way to further tax top incomes, provided the tax administration has the necessary enforcement capacity.

Entrepreneurial income—another sizeable share of earnings by top incomes—is relatively vulnerable to tax avoidance and evasion. Avoidance opportunities loom large as self-employed people can organise themselves as closely held corporations whereby the owner-director can pay himself either a salary (subject to the PIT) or dividend (subject to dividend tax). Preventing this type of avoidance requires that the overall tax rates on labour and capital income are not too far apart. Evasion among the self-employed is also usually large due to the absence of third-party reporting and the scope for entrepreneurs to underreport sales and overreport costs. Dedicated efforts by the tax administration—by, for example, targeting professionals or high-wealth individuals—can help address this type of evasion. However, such efforts are still in their infancy in most developing countries.

The difficulties with the taxation of capital income also highlight the importance of the corporate income tax (CIT) as a backstop for the PIT. Indeed, the CIT serves as an effective withholding mechanism for taxes on equity income at the company level—including for retained earnings that lead to capital gains. Maintaining a reasonably high CIT rate is therefore important for sustaining an enforceable

income tax system. However, CIT rates have been under significant pressure from international tax competition, which has caused sharp declines in rates worldwide—from around 40-45 per cent in the 1990s to 20-25 per cent in 2019 (Figure 2). International coordination, such as the recent agreement on a global minimum effective tax rate, could mitigate the risks of a declining trend.

### Taxing top wealth

Net wealth taxes (NWTs)—imposed on the sum of financial and non-financial wealth minus liabilities—target largely the same base as capital income taxes. The base of a NWT might be broader, however, as non-income generating assets can be included as well, although difficulties with valuation often lead countries to exempt them from NWTs (e.g., primary residences, pension assets; farm and business assets, artwork, jewellery, shares in unlisted businesses). Most countries prefer capital income taxes over NWTs for several reasons. For instance, wealthy households on average generate higher rates of return, e.g., due to more risk-taking, so that the effective tax burden on capital income will be more progressive under a capital income tax. NWTs also raise liquidity issues, as there might be no flow of income from which the tax can be paid—which might be especially problematic for middle income households. Finally, NWTs are also less effective automatic stabilisers as tax is levied even when returns are low or negative.



Photo: UN Women/Fahad Abdullah Kaizer. People wait for relief aid at Shahjahanpur area in Dhaka, Bangladesh, 2020 <[is.gd/LNU8I4](https://www.is.gd/LNU8I4)>.

Countries still often complement their income tax systems with selective taxes on the stock or the transfer of wealth, including through progressive NWTs, property taxes and wealth transfer taxes. On average, the revenue of these taxes is around 2.5 per cent of the gross domestic product (GDP) in advanced economies, but much lower in emerging market economies (1 per cent of GDP) and low-income countries (0.2 per cent of GDP). Recently, wealth taxes have received renewed interest to increase public contributions by wealthy individuals.

Some countries (such as Belgium, Italy, Norway, Spain, and Switzerland) complement their capital income tax systems with a progressive NWT—applied above a sometimes fairly high wealth threshold (which could mitigate liquidity issues raised above). Exempt assets often narrow the base and open the door for tax avoidance. Moreover, evidence suggests that NWTs have also encountered ample tax evasion, most notably by the wealthiest individuals. For instance, it was found that in Denmark and Switzerland, a 1 per cent wealth tax reduced reported wealth by over 40 per cent. During the last few decades, therefore, several countries have repealed their NWTs, often due to their low yield relative to administrative costs (e.g., Australia, Canada, Pakistan, and several European countries). Better prospects for enforcing a NWT might be possible if dedicated administrative efforts, combined with automatic exchange of information between countries, could more effectively

address offshore tax evasion, although this might be less viable in the short term for developing countries with weak administrations.

Estate or inheritance/gift taxes aim to effectively limit intergenerational wealth inequality and enhance equality of opportunity. Although most advanced economies impose them, these taxes have often proved difficult to implement due to ample tax exemptions (such as for capital gains), sometimes very high thresholds, and widespread avoidance and evasion. Of course, reforms can be designed to close loopholes, reduce thresholds, shift liability from the estate to heirs, and improve enforcement.

Recurrent real property taxes—imposed on gross property values—are more popular. They are usually a source of financing for local governments. To the extent that the revenue from recurrent property taxes is earmarked for local public services that closely match the value of the taxes paid, they resemble a benefit tax—not a redistributive tax. However, property taxes can be made progressive by imposing higher tax rates on properties of higher value or by using the proceeds for more redistributive spending. In developing countries, there is often scope to exploit property taxes more fully by raising tax rates, updating property values to current market prices, improving registries and scaling up administrative capacity. Where market-based valuation is hard, simplified approaches based on property areas can

produce reasonable outcomes at lower administrative costs.

#### **Towards an inclusive recovery**

Clearly, there is no one-size-fits-all approach towards addressing inequality through the tax system. Increasing taxes on people with high incomes and wealth seems feasible in some countries. However, the scope for doing so might be more limited elsewhere, at least in the short term, due to institutional and enforcement constraints. This highlights the need to build tax capacity to enhance enforcement. Yet, even for those countries, inequality can still effectively be reduced by enhancing other taxes that are often easier to enforce, such as value-added taxes (VAT) and excises, or by levying new taxes, such as on carbon. Using their proceeds to fund progressive social spending could effectively make economic recovery more inclusive.

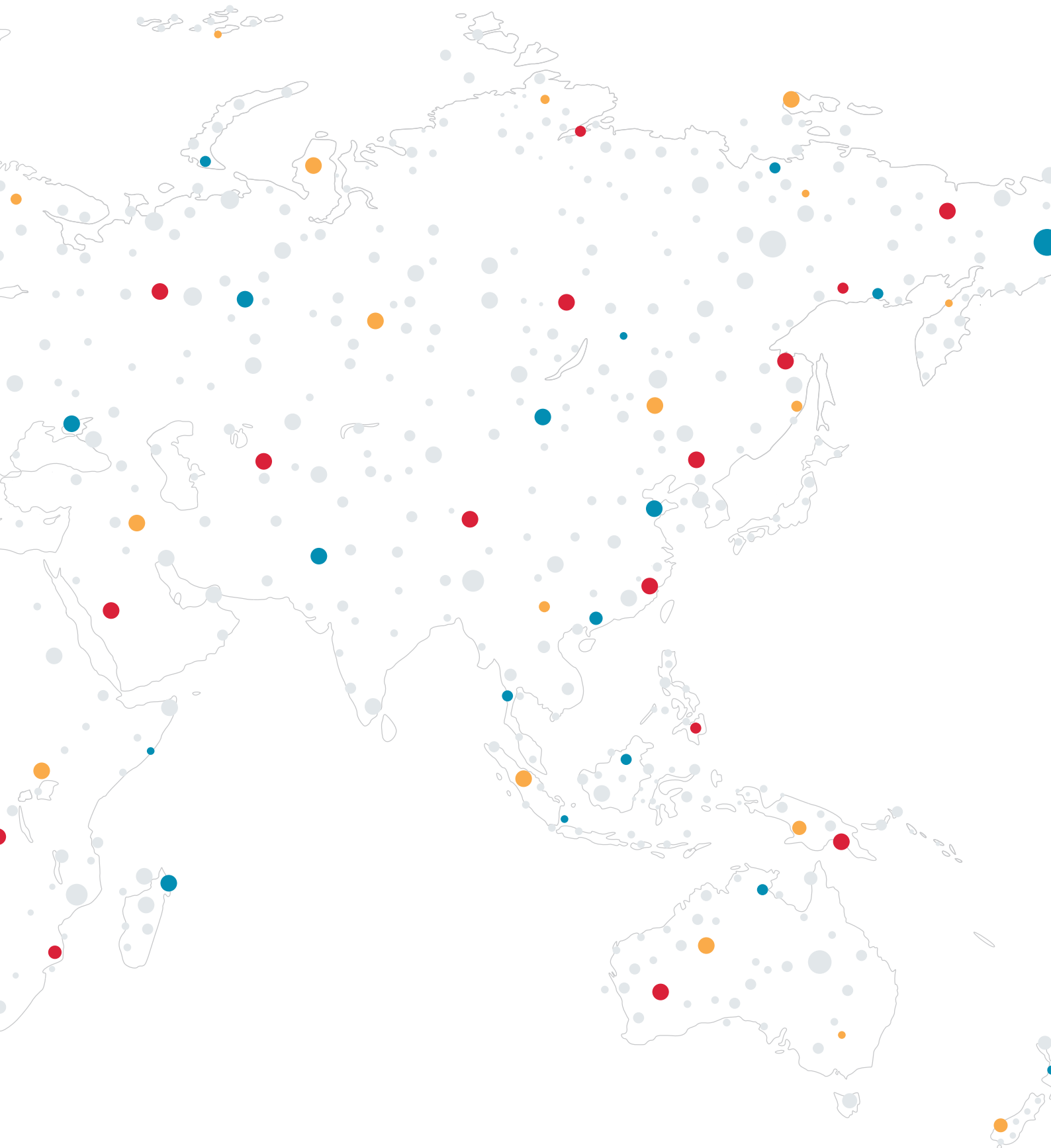
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1. The views expressed in this paper are those of the authors and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.
2. International Monetary Fund. This paper draws on Abdelkader and de Mooij (2020) and the references therein.

“ Even before the COVID-19 pandemic, income inequality in many countries was high and rising.







The greatest injustice of the U.S. tax system today is its regressivity at the very top: billionaires in the top four hundred [highest earners] pay less (relative to their true economic incomes) than the middle class. ”

**Emmanuel Saez and Gabriel Zucman**

Wealth taxes are one possible way of addressing wealth inequality. ”

**Sarah Perret**

The underutilisation of overall wealth taxes in mobilising resources is evident in India, as in other developing countries. ”

**Sakti Golder**



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ISSN: 2318-8995



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