

TaxDev

Wealth-related taxes in low- and middle-income countries

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Introduction

- Address high levels of income & wealth inequality + collect more revenues in fairer ways:
 - Top policy priority: national gov't, international initiatives & GDC
- Recent estimates: wealthiest pay too little income tax (% of their income)
 - << those at the bottom of the distribution of income
 - Hide their income and wealth from authorities
 - Exploit loopholes
 - due to bad policy design & implementation // lack of international cooperation.
- Increasing calls for taxes on net wealth
 - Several national and international proposals and reforms
 - Global minimum tax on super rich being advocated by G20 Presidency & EU Tax Observatory.
- This presentation:
 - Deep dive on taxes on the stock of wealth in the context of wide *national* tax systems
 - Consider wealth-related taxes more broadly: capital income tax & inheritance tax

The presentation is structured as follows:

- Defining and measuring wealth
- Wealth-related taxes
- Prevalence of wealth-related taxes in bilateral partners of GDC
- Rationale for taxing net wealth
- Taxing net wealth: design and practical consideration
- Main takeaways

Defining wealth

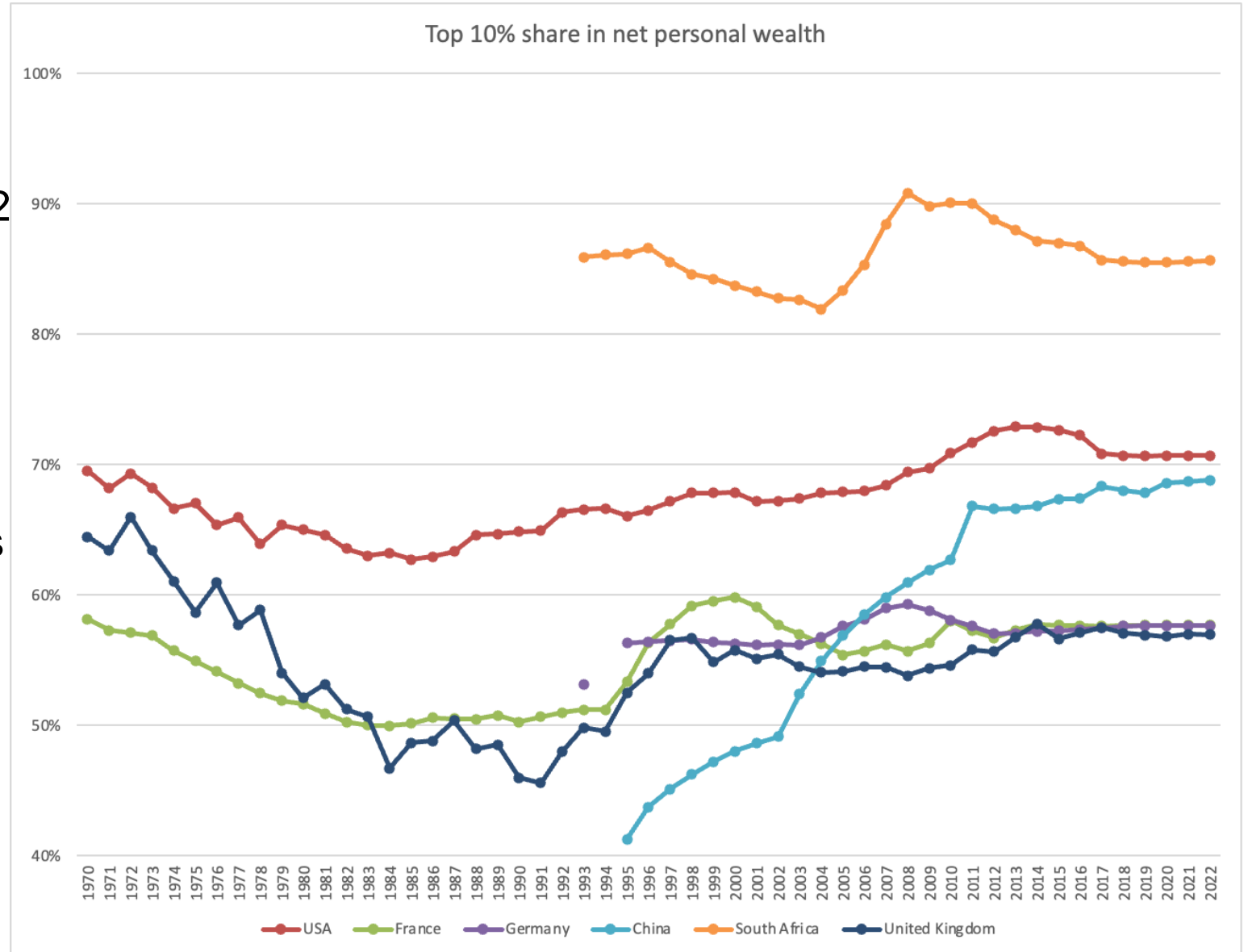
- We consider private wealth held by individuals (or households) in the form of different assets:
 - Movable physical assets (cars, boats, artwork)
 - Immovable property (buildings, main residence, land)
 - Private pensions
 - Other financial assets (such as government bonds, company shares & cash)
- Often wealth is calculated as the net value of assets
 - For example, value of main residence minus value of mortgage or the value of financial assets minus other debts

Measuring wealth is challenging

- Hidden assets (e.g. offshore) and underreported value
 - More prevalent among wealthy individuals
 - Affects measures of inequality
- Valuation varies across different assets
 - Trickier for holdings in family businesses, some immovable property and movable property (such as artwork)
 - Easier for shares in listed companies and government bonds or cash held in bank accounts
- Imperfect data sources on assets, asset values and assets' ownership, and wealth distribution
 - Administrative data from wealth-related taxes
 - Wealth surveys and other household surveys
 - List of rich people
 - Scarcer in LMICs
- Sometimes conflicting estimates for the same country (e.g. Carranza et al, 2023 – LAC)

Some facts on wealth levels and distribution

- Private wealth has increased faster than income & is many factors larger (OECD, 2021, Chancel et al, 2022)
- Wealth concentration >> income concentration (Ibid)
- Level of wealth inequality and trends vary across countries
 - across inequality measures & sources



Wealth: sources, uses and composition

- Wealth sources
 - Earnings, gifts and inheritances, returns to existing wealth (normal and above normal)
 - Returns: dividends, interests, rental income, capital gains, business profits
- Wealth uses
 - Consumption, invest, transfer (gift and inheritances)
- Variation in sources, uses and asset composition
 - across individuals over the wealth distribution
 - beyond lifecycle

Wealth-related taxes: 3 different types

- Capital income taxes (returns to wealth):
 - interest income, dividends, royalties, rental income from immovable and movable property as well as capital gains (i.e. on the increase in the value of an asset between its purchase and when it is disposed of).
- Taxes on the transfers of wealth:
 - estate taxes (imposed on the value of the donor's total net wealth at the time of death)
 - inheritance taxes (imposed on the value of the assets the beneficiary receives from the deceased donor),
 - gift taxes (imposed on the value of the assets the beneficiary receives from a live donor),
 - taxes on market exchange of assets, from financial assets and bank transfers to real property.
- Taxes on the stock of wealth:
 - broad or net wealth taxes ('wealth taxes') imposed on the value of most or all types of assets held by an individual minus the related debts;
 - taxes on the ownership of immovable property (often referred to property taxes or real estate), and
 - taxes on the ownership of movable property (from cars and aircrafts to financial assets).

Prevalence of wealth-related taxes in bilateral partners of German Development Cooperation

Tax Type	No. partners (total 38)	% partners
Capital income tax		
Capital gains	36	95%
Taxes on wealth transfers		
Estate, inheritance or gift taxes	8	21%
Other transfer / stamp tax	37	97%
Taxes on the stock of wealth		
Wealth tax	3	8%
Taxes on immovable property	36	95%

3 Partners with broad *permanent* taxes on wealth

Country	Rate Structure	Tax-Free Allowance (Approx. US\$ equivalent, as at Nov 2023)	Taxable Person	Assets Taxed
Algeria	0.15% to 1%	US\$ 0.73 million	Individuals: worldwide assets of residents; assets in Algeria for non-residents	Net wealth values of various assets e.g. real estate, vehicles, boats, aircraft, art, racehorses
Bolivia	1.4% to 2.4%	US\$ 4.3 million	Individuals: worldwide assets of residents; assets in Bolivia for non-residents	Net asset value e.g. real estate, personal property, luxury goods, financial holdings and owned intellectual property, cash, and other tangible and intangible assets, less outstanding liabilities.
Colombia	0.5% to 1.5% until 2026; 0-5% to 1% 2027 onwards	US\$ 0.75 million	Individuals: worldwide assets of residents; assets in Colombia for non-residents; and foreign entities with assets located in Colombia	Net wealth = various assets e.g. real estate, yachts, boats, art, aircraft or mining or oil rights (other than shares, accounts receivables, portfolio investments, and/or financial leasing contracts with entities or persons resident in Colombia).

Bangladesh: surcharge rate for PIT based on wealth // Ecuador: one-off wealth tax repeatedly

Taxing the stock of wealth?

- Objective is to raise revenues in a fair way & lower inequality in income and wealth through tax and benefit system
 - Wealthy and super-rich pay too little income taxes
 - Use net wealth tax?
- Broader consensus:
 - Improving progressivity and effectiveness of taxes imposed on capital income and wealth transfers may be desirable to increase fairness of tax system & social contract
- Lack of consensus:
 - Whether a well-designed national tax system should include recurrent taxes on net wealth
 - Better to tax wealth through capital income taxes & inheritances taxes?
 - Net wealth taxes:
 - Distorts behaviour more? Migration, saving and investing, evasion, other.
 - More costly to administer and comply with?

Taxing wealth sources & uses more efficient + equitable?

- Higher wealth can come from different sources:
 - Higher earnings and saving for future consumption - tax progressively earnings if returns on savings same for all (though often they are not)
 - Higher returns to capital due to luck, skill, effort or some other advantage - tax 'excess' returns without taxing the 'normal' return that just compensates for delaying consumption – wealth tax does the opposite
 - Inheritances and gifts – tax these by a well-designed inheritance tax
- Taxing sources of wealth directly
 - Tax those with higher lifetime resources more accurately without penalising saving
- Same applies to taxing all uses of wealth (consumption, transferring wealth)
- Taxing the stock of wealth → taxing less heavily higher returns to capital
 - Less equitable and efficient than taxes on capital income
- Need to consider interaction with other taxes when choosing design and implementation
 - Interrelated revenue, efficiency & equity impacts

Net wealth tax as complementary tool?

- Too high levels of wealth concentration today - harmful for society
 - Wealth may confer other benefits beyond (delayed) consumption: political power, undermine democracy
 - Environmental damage caused mainly by the super-rich? They should pay more
 - Use other instruments in a toolkit?
 - E.g. Regulate markets & empower workers to reduce concentration pre-tax
 - Still could use wealth tax could remediate previous mistakes
- Taxes on income and wealth transfers imperfect: wealthy pay none or too little tax
 - Equity and efficiency properties of all wealth-related taxes can be eroded by policy choices that result in arbitrary exemptions and loopholes
 - Evasion and avoidance and other behavioral responses
 - Tax net wealth to complement & diversify revenue sources
 - But more complexity & costs of taxing more bases
 - Not clear taxing stock of wealth is easier to administer than other wealth-related taxes

Net wealth taxes: emerging evidence on behavioural impacts

- Nascent and sometimes conflicting evidence
 - Most from the few countries that have a net wealth tax & good individual data
 - HICs (Scandinavia, Switzerland, Spain) – not much from L&MICs
- May reduce taxable wealth
 - Taxpayers may change their real (e.g. savings or migration) or reporting behaviour
- Large evasion and avoidance responses
 - Driven by design loopholes, implementation decisions and reliance on self-reporting of assets to the tax authorities
 - Introduction of third-party reporting on specific assets → assets revealed.
 - Design broad base taxes that include all assets and minimum evasion/avoidance opportunities
- Migration effects
 - *Intranational* migration when rates vary across states
 - Small impact of increasing rates on outflows of top 2%, but modest aggregate impact on the economy

Net wealth taxes? Not obvious answer, further considerations

- All in all, better to tax comprehensively and progressively capital income, including capital gains, and lifetime inheritance flows than taxing net wealth.
 - Improve design & implementation of capital income taxes
 - Consider effective inheritance taxes
 - International tax cooperation – improve CIT performance & taxation of wealthy that are more mobile, close loopholes
- Increasing consensus on complementary net wealth taxes targeting the super-rich
 - Either at the national level or as part of global minimum tax,
 - Ensure that these individuals that pay virtually no income tax pay their fair share in taxes.
- Net wealth taxes in the context of the whole tax (and benefit) system
 - Interaction with other taxes in achieving policy objectives in the most efficient, equitable and cost-effective way
 - Not as a substitute for capital income taxes
 - How revenue is spent matters

Taxing the stock of wealth: design and practical considerations

- Many aspects to consider and quantitative analysis to conduct:
 - who is taxed (unit of taxation) – pros and cons of individuals vs household
 - what is taxed (the type of assets included in the tax base) – broad to avoid changes in holdings
 - valuation issues – complex and varying across assets, but improving technology
 - the threshold and the rate structure – high threshold & progressive rate structure, context specific
 - how liquidity constraints for those asset-rich and income-poor may play out,
 - whether it is a tax at the national or local government level,
 - administrative capacity and taxpayers' compliance and related costs
 - Third-party information and international & intranational coordination and collaboration
 - Admin & Compliance costs also depend on underlying distribution of wealth & design of tax
 - economic behaviour in response to such a tax – need more evidence
- All these would determine efficiency, equity and revenue impact of such a tax.

Taxing the stock of wealth? Ambiguous answer

- Ambiguous answer to the question of whether L&MICs should tax net wealth (in addition to or in place of taxing capital income).
- Country context is key but little information about distribution, level and composition of wealth and how (high-income) taxpayers respond to taxes in L&MICs.
- There is ample room to improve existing capital income taxes in L&MICs
 - valuable even for countries with little revenue potential from this tax base in short run
- Key priority to develop data infrastructure, analytical capacity at both admin and MoF levels and administrative capacities
 - Enforcement capacity, exchange of information & other third-party reporting
 - Adequate legal frameworks
 - Ability to effectively participate in international tax cooperation, including contributing to and using a global asset registry

THANK YOU!!!!