CHASM | Centre on Household Assets and Savings Management

Briefing Paper

Wealth taxes: problems and practice around the world

There has been considerable recent debate, both in the popular press and in more academic circles,[1] about the possibility of introducing a wealth tax of some form or another in the UK. But what exactly is a wealth tax, why might such a tax be a good idea in the UK and what are its main advantages and disadvantages? And to what extent are wealth taxes more or less popular around the world nowadays compared to other taxes and to other times?

There are three possible forms that a wealth tax (sometimes referred to as a capital tax – the terms are interchangeable) can take. We can tax the **holding** of capital or wealth (as in an annual wealth tax, or a net worth or net wealth tax); and/or we can tax the **transfer** of capital or wealth (as in taxes on death, or taxes on gifts); and/or we can tax the **appreciation** of capital or wealth (as in a capital gains tax, or CGT). The characteristic of capital or wealth taxes is that in principle they relate to the whole range or genus of assets: cash and bank balances; real property such as houses; personal property such as jewellery, pictures, furniture, cars and boats; stocks and shares; and business assets.

Taxes on wealth have never been as popular or widespread as taxes on the other two major tax bases – income and expenditure. Virtually every country around the world uses income taxes (whether on individuals, companies or other entities) and most also use expenditure taxes (such as the value added tax which appears in some form or another in most developed countries, or the customs and excise duties that are likely to be more relied upon in developing countries). Between them these two tax bases (income and expenditure) account for the vast majority of tax revenue for most countries.

[1] See, for example, Chapter 15 of *Tax by Design, The Mirrlees Review* published by the Institute for Fiscal Studies, 2011, which provides a comprehensive review of current issues relating to wealth taxation. Also see the briefing paper on 'Should we introduce a (temporary) wealth tax?' at http://www.birmingham.ac.uk/Documents/college-social-sciences/social-policy/CHASM/briefing-papers/2012/briefing-paper-temp-wealth-tax-sept2012.pdf

On the other hand, wealth taxes, where they do exist, account for relatively small amounts of total tax revenue. For example, in the OECD (whose 34 members are among the richest countries in the world) the combined tax revenue derived by member countries from annual wealth taxes and wealth transfer taxes accounts, on average, for less than 1% of their total tax revenue.[2] It is difficult to measure the contribution that the third form of wealth tax – the CGT – makes to total tax revenue as its revenue is generally included in the income tax collections rather than as a separate category.[3] But in the UK revenue from CGT rarely exceeds 2% of total tax revenue; and in Australia – where the CGT regime is more comprehensive and there is no annual exempt amount as in the UK – the CGT usually only contributes between 2% and 4% of tax collected.

Most developed countries now have forms of CGT (New Zealand is the notable exception in OECD countries) and CGT has also been – after VAT – the tax most likely to be introduced in developing and transitional countries in the last 30 years or so. But the other two forms of wealth tax (wealth holding taxes and wealth transfer taxes) are not as prevalent as might otherwise have been expected.

Indeed, taxes on the holding of wealth (such as annual wealth taxes on individuals) have steadily declined in recent decades. In 1990 exactly half of the OECD countries had such taxes. By 2000 the proportion was just over one third. And by 2010 such taxes only existed, on an on-going basis, in France, Norway and Switzerland (at the cantonal level). The global financial crisis has caused some countries to re-introduce annual wealth taxes on individuals, some on a temporary basis. Iceland, which had abolished the tax in 2006, reintroduced a wealth tax for a finite period in 2010. Spain also temporarily restored its net wealth tax in September 2011, having abandoned it in 2008. Most recently Cyprus has had to introduce a capital levy (a distinctive form of tax on the holding of one aspect of wealth, in the form of bank savings) as part of its Eurozone bail-out arrangements in 2013. But these examples are exceptions to the more general trend of the decline of wealth taxes on the holding of wealth.

[2] OECD Revenue Statistics, 2010.

[3] Arguably, capital gains are a form of income and so are often treated as part of the income tax base rather than the wealth tax base.

So far as non-OECD countries are concerned, there are not many countries – even in the developing world – where annual wealth taxes are used. For example, they do not exist in Brazil, China, Indonesia, Russia or South Africa. India is a notable exception – its annual wealth tax currently operates at the rate of 1% on wealth above a threshold of 3 million rupees (roughly £36,000).

In contrast to annual wealth taxes, the decline in the number of developed countries with wealth transfer taxes (such as death duties and gifts taxes) has been relatively small in recent decades. There has also been something of a shift away from estate-type death duties (where the tax is levied on the estate of the deceased, as in the UK[4] and USA) to inheritance-type taxes (where the tax is levied on the beneficiaries – possibly at varying rates depending upon the relationship to the deceased – as in all other OECD countries with wealth transfer taxes). All OECD countries had wealth transfer taxes in the 1960s. By 1999 21 of the 24 member countries had them; and in 2010 23 out of 30 OECD countries used wealth transfer taxes.

This slight downward trend in the prevalence of wealth transfer taxes in developed countries is matched by a similar trend in developing and transitional countries. Sri Lanka, Bangladesh, Pakistan and Indonesia are all examples of countries that have abolished elements of wealth transfer taxes that were previously utilised.[5] As a result, and overall, less than half of developing and transitional countries now use net wealth taxes and/or wealth transfer taxes.[6]

Two main problems – disclosure and valuation – prevent wealth taxes being more prevalent than otherwise might be the case, particularly so far as taxes on the holding of wealth are concerned. The problem of disclosure is obvious – it is very easy to hide many forms of wealth, whether in the form of physical assets like diamonds or fungible assets like bank balances. Compliance becomes a real problem; hence inequities begin to arise between honest and dishonest taxpayers; and revenue authorities introduce compromises (such as exempting household articles) which inevitably undermine the efficiency, equity and integrity of the tax. Valuation is also a major problem, especially where an actual sale of the asset does not take

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[4] Somewhat inappropriately, the UK wealth transfer tax on death is labelled an 'inheritance' tax when it is in fact an 'estate' tax.

[5] Ernst and Young, *International Estate and Inheritance Tax Guide*, 2012.

[6] Michael Strawczynski, 'The optimal inheritance tax in the presence of investment in education', (2012, Hebrew University of Jerusalem Working Paper, 24).

place to give an independent market value. In addition, if a wealth tax is to have any consistency of meaning, assets such as the capitalised value of future pension rights, or of future earning power, may need to be included in the tax base. But there is no consensus on whether they should be included, and if so, how they should be measured.

Notwithstanding these real problems, there are very powerful arguments in favour of wealth taxes, whether on the holding, transfer or appreciation of wealth. At least five strong reasons exist in favour of such taxes. In the first place there are arguments based upon the notion of horizontal equity – the equal treatment of those with the same taxable capacity. Wealth taxes are needed to supplement the income tax to take account of the additional taxable capacity conferred by wealth, irrespective of the income, if any, derived from it. Secondly, and allied to this, is the notion of vertical equity (the heavier taxation of those with greater taxable capacity, usually interpreted as progressive taxation). Simply put, wealth taxes can check or reduce inequalities of wealth and income.

A third reason in favour of wealth taxes, often put forward by economists, is that of efficiency. It is suggested that because a wealth tax imposes a charge on wealth irrespective of the income that derives from the underlying assets, it acts as an encouragement to use the assets more productively. Thus if someone owns land which is allowed to lie waste, there is no income tax payable on it. But if there is also a wealth tax the owner will be encouraged to cultivate it, or develop it, or sell it to someone who will use it more productively.

The fourth reason for imposing wealth taxes is administrative, in that such taxes can provide the revenue authority with very useful data that can help check and prevent evasion of other taxes. For example, returns on wealth can be cross-checked with investment income returns and with data on inheritances and gifts. And finally imposing wealth taxes – even if they do not raise much revenue – can perform an invaluable political signalling role in society, for example letting those without wealth know that it is not just they that have to make all the sacrifices in times of financial hardship (when welfare provision is continually being curtailed).

For all these reasons, wealth taxes – whether they are imposed on the holding, transfer or appreciation of wealth – will continue to feature in debates about the appropriate mix of taxes in contemporary society. It is unlikely that such taxes will ever be more than a minor part of that mix, and taxes on the holding of wealth may well continue to lose ground compared to other taxes and other times, even in the current uncertain economic climate that confronts many governments around the world. But wealth transfer taxes, particularly in the form of inheritance-type taxes on death, and wealth appreciation taxes, as epitomised by the CGT, will continue to play important roles in modern tax systems.

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